

**PUBLIC SERVICE COMMISSION  
OF WEST VIRGINIA  
CHARLESTON**

**Case No. 09-0871-T-PC**

**Citizens Telecommunications Company  
of West Virginia, dba Frontier Communications  
of West Virginia and Verizon West Virginia Inc.**

**Joint Petition for consent and approval of  
the transfer of Verizon's local exchange  
and long distance business in West  
Virginia to companies to be owned and  
controlled by Frontier Communications**

---

**Direct Testimony of Randy Barber  
on Behalf of the Communications Workers of America, AFL-CIO**

---

**November 16, 2009**

**PUBLIC (REDACTED) VERSION**

## Table of Contents

Introduction .....	1
Background .....	2
Organization of Testimony .....	5
Summary of Testimony .....	5
Overview of Application and Document Review .....	7
Concerns with Frontier and the Proposed Transaction: Unrealistic Savings and Illusory Benefits .....	12
Frontier Lacks Financial Fitness: Frontier’s Unsustainable, High-Risk Business Model .....	17
A Frontier Acquisition Would Significantly Weaken VSTO (Verizon’s Operations in West Virginia and 13 Other States).....	30
Frontier’s Highly Aggressive And Unrealistic Financial Projections Risk Overestimating Future Revenues And Underestimating Future Expenses, Possibly By Significant Amounts	34
Frontier Plans to Reduce Capital Expenditures .....	49
Putting it Together: Frontier is Not Financially Fit to Own and Operate VSTO .....	55
Conclusion .....	60

1   **INTRODUCTION**

2   **Q.     Please state your name and business address.**

3   A.     My name is Randy Barber. My office address is: Suite 204, 6935 Laurel Avenue,  
4           Takoma Park, Maryland 20912.

5   **Q.     By whom are you employed and in what capacity?**

6   A.     I am employed by the Center for Economic Organizing and serve as its president.

7   **Q.     On whose behalf are you testifying in this case?**

8   A.     I am testifying on behalf of the Communications Workers of America.

9   **Q.     Why is CWA interested in this case?**

10  A.     CWA represents approximately 1,750 employees of Verizon-WV and a number of  
11           employees of Frontier. These employees represented by CWA include operators,  
12           consultants, and system technicians who work to provide telecommunications service in  
13           West Virginia. CWA is concerned about the financial health of its employer, as well as  
14           the employer's ability and commitment to safely and reliably operate and maintain that  
15           company's telecommunications network in West Virginia.

16  **Q.     Have you been engaged to offer expert analysis and testimony on the proposed**  
17           **Frontier-Verizon transaction in other regulatory proceedings?**

18  A.     Yes. I have been jointly retained by CWA and the International Brotherhood of Electrical  
19           Workers ("IBEW") to provide analyses and testimony concerning this proposed

transaction. I expect to participate in the unions' interventions before commissions in several other states.

**BACKGROUND**

**Q. When you were engaged by CWA on this case, what were you asked to do?**

A. I have been asked to provide expert analysis and testimony, focusing on financial issues.

**Q. Do you have experience in rendering that type of opinion as an expert witness?**

A. Yes. While I do not specialize in being an expert witness, I have performed that function on several occasions, and I have assisted experts and attorneys in the financial and analytical aspects of judicial, quasi-judicial and regulatory proceedings. Most relevantly, I served as the financial expert for CWA and the IBEW in two recent telecommunications transactions: FairPoint Communications' acquisition of Verizon's Northern New England landline business, and the merger of Embarq and CenturyTel that formed CenturyLink.

**Q. What in your educational and employment background has qualified you to provide an expert opinion on financial issues such as those presented in this case?**

A. After attending Dartmouth College, I have worked as a financial consultant for more than 25 years. I specialize in complex financial and operational analyses of companies and industries, sometimes in the context of collective bargaining, other times in support of clients' strategic or policy interests. My clients tend to be labor unions and pension funds. I also regularly analyze a wide range of issues impacting specific employee benefit

40 plans. Among the companies that I have analyzed are Alcatel, Avaya, AT&T, Boeing,  
41 Catholic Healthcare West, Celestica, CenturyTel, Columbia/HCA, Eastern Air Lines,  
42 Edison Schools, Embarq, FairPoint Communications, Idearc, Lucent Technologies, MCI,  
43 Oregon Steel, Qwest, RH Donnelley, Sprint, Sylvan Learning Systems, Texas Air  
44 Corporation, TIAA-CREF, United Air Lines, the United States Postal Service, Verizon,  
45 and Wal-Mart. More broadly, I have provided clients with various analyses of such  
46 industries as aerospace manufacturing, air transport, for-profit education, newspaper  
47 publishing, off-road vehicle manufacturers, and telecommunications and internet access  
48 and content providers.

49 In addition, I have performed a wide range of analyses of private sector pension  
50 plans and public employee retirement systems across the country. These include  
51 investigations into factors associated with under-funding, integration of two or more  
52 benefit plans, efforts to improve the operations of benefit plans, evaluations of proposed  
53 investment and funding mechanisms, and proposals to convert defined benefit plans into  
54 defined contribution plans. A number of the activities mentioned above have taken the  
55 form of joint labor-management initiatives in which I served as the union expert, paired  
56 with one or more management experts. Some of these projects included work with  
57 AT&T, Lucent Technologies, and the League of Voluntary Hospitals and Nursing Homes  
58 (New York City and environs).

**Q. Please summarize your experience as an expert financial witness.**

A. As mentioned above, I was an expert financial witness in the FairPoint/Verizon transaction before the regulatory commissions in Maine, New Hampshire, and Vermont. In addition, I have testified as an expert witness (either at trial or by deposition) in several judicial proceedings and arbitrations. These have included, for example, a class action law suit involving A.P. Moller-Maersk/BTT, a National Mediation Board Single Carrier proceeding, the Big Sky Airlines Bankruptcy, and an Examiner's Investigation into the Bankruptcy of Eastern Air Lines. I have also served as an expert consultant in various proceedings where it was not necessary for me to testify, such as an airline fitness investigation involving ATX, a cross-border airline merger investigation (American Airlines-Canadian Airlines), and a major CWA/AT&T arbitration.

**Q. What is the scope of your testimony?**

A. I am advised by counsel that the West Virginia Supreme Court of Appeals has long held that the primary purpose of the PSC is to "serve the interests of the public". In addition, as this Commission noted in its Order of July 23, 2009 in this matter, in order to consent to this proposed acquisition the Commission "must find that the terms of and conditions of the transactions are reasonable, that neither party is given an undue advantage over the other, and that the transactions do not adversely affect the public in this state."<sup>1</sup>

---

<sup>1</sup> Order at page 3. see W.Va. Code section 24-2-12

78  
79 Generally, I refer to this as the question of Frontier's financial fitness to own and operate  
80 Verizon's landline business in West Virginia. I also discuss the risk that Frontier will not  
81 attain the synergies -- as well as the revenues -- upon which the success of the proposed  
82 transaction rest.

83 **ORGANIZATION OF TESTIMONY**

84 **Q. How is your testimony organized?**

85 A. The first part of my testimony contains an analysis based on publicly available  
86 information. The next section expands on this analysis, based on purportedly  
87 Confidential information provided by either Verizon or Frontier. Finally, I set forth  
88 recommendations for the Commission's consideration.

89 **SUMMARY OF TESTIMONY**

90 **Q. Please summarize your major findings and recommendations.**

91 A. My findings are summarized as follows:

- 92 1. Frontier is not fit to assume ownership and control of the Verizon Separate Telephone  
93 Operations. Frontier has relied upon quite aggressive revenue and expense assumptions to  
94 justify the transaction internally.
- 95 2. If Frontier falls significantly short of its revenue and expense goals, it would likely  
96 come under severe pressure to reduce service-related spending, cut capital expenditures,  
97 and lower its dividend payments, probably a combination of all three.

98 3. Given the potential for such a failure in Frontier's plans -- and they need not be of the  
99 FairPoint magnitude to have serious negative ramifications -- the risks associated with  
100 this proposed transaction are simply too great.

101 4. Based on my analysis, I can unequivocally recommend to the Commission that it not  
102 approve this transaction.

103 5. Although I believe that any attempt to cure the flaws in this deal will still leave a  
104 weakened Frontier and VSTO (and should thus be denied as well), if the Commission  
105 determines that it should indeed give the Applicants the opportunity to cure the flaws in  
106 their transaction, I recommend that the Commission establish conditions that would  
107 insure Verizon's continued involvement (and interest) in the properties it is trying to sell  
108 to Frontier. Fundamentally, the idea would be to ensure that Verizon retain significant  
109 "skin in the game." As I describe in greater detail below, there are two alternatives that I  
110 believe could help achieve that goal:

111 a) Require Verizon and Frontier to form a Joint Venture, with meaningful  
112 milestones which the Joint Venture would be required to achieve before Verizon would  
113 be permitted to complete its sale (and Frontier allowed to consummate its purchase).

114 b) Require Verizon to provide Frontier with a long-term warranty (or guarantee)  
115 on all critical elements of the property it seeks to sell, again with meaningful milestones  
116 which must be reached prior to allowing Verizon to terminate its guarantees.



117 6. If the Commission declines to reject the transaction and further declines to require the  
118 parties to enter into a Joint Venture (or for Verizon to issue a warranty or guarantee), I  
119 have listed a set of financial conditions that could help protect West Virginia  
120 communities and customers.

121 **OVERVIEW OF APPLICATION AND DOCUMENT REVIEW**

122 **Q. Please describe your understanding of the proposed transaction.**

123 A. On May 13, 2009, Verizon and Frontier entered into a series of agreements that would  
124 enable Frontier to become the owner of Verizon's landline business in 13 states and a  
125 portion of a fourteenth state. The first step in the transaction is the creation by Verizon of  
126 a new subsidiary that would become the holding company for all of the businesses being  
127 transferred to Frontier. The agreements refer to this holding company as Spinco. In  
128 subsequent filings with the Securities and Exchange Commission, this holding company  
129 is referred to as Verizon Separate Telephone Operations or VSTO. The terms Spinco and  
130 VSTO can be used interchangeably, but I will generally refer to the new holding company  
131 as VSTO.

132 The next step in the transaction would be for VSTO to merge with and into  
133 Frontier, so that VSTO becomes a wholly owned subsidiary of Frontier. The actual steps  
134 of the transaction are more complex than this because of income tax rules that Verizon  
135 will follow in order to make the transaction tax-free to Verizon and its stockholders.

136 In exchange for VSTO, Verizon's stockholders will receive common stock in  
137 Frontier and Verizon will receive approximately \$3.3 billion in cash and debt relief.  
138 Again, there are several steps in this process because of the tax rules, but the effect is that  
139 Verizon will receive cash (or reductions in its debt) of \$3.3 billion and Verizon's  
140 stockholders will end up owning a majority of Frontier's common stock (estimated at  
141 between 66% and 71% of Frontier's stock, depending on Frontier's stock price near  
142 closing). The stipulated value of the Frontier equity to be distributed to Verizon  
143 shareholders is \$5.247 billion, bringing the total transaction value to \$8.58 billion.  
144 However, the value of the Frontier shares to be distributed to Verizon shareholders could  
145 increase by any amounts that Verizon is required to pay or forgo in order to obtain  
146 regulatory approvals for the transaction, thus further diluting existing Frontier  
147 shareholders' stake in the firm.<sup>2</sup>

148 Essentially, Verizon has created -- and Frontier has acceded to -- an insurance  
149 policy against the actions of public utility regulators. If various state commissions  
150 require, as a condition of approval, Verizon to fund specific projects, guarantee the asset  
151 it seeks to sell, directly reduce the price, or otherwise negatively impact the proceeds  
152 Verizon realizes, Frontier is required to issue additional shares at the stipulated  
153 transaction price in sufficient amounts to make Verizon shareholders whole. It seems to

---

<sup>2</sup> Frontier Corp. Prospectus, Form 424B3, filed with the Securities and Exchange Commission on Sept. 16, 2009 (hereafter "Prospectus"), first page of Mary Agnes Wilderotter cover letter to Frontier Shareholders.

me that Verizon insisted on this provision after regulators in the Northern New England states effectively required it to reduce its price by some \$360 million in the FairPoint transaction.

**Q. In order to render an opinion about the financial analyses presented by Verizon and Frontier in this case, what information do you need to review?**

A. Ideally, I should be able review all relevant information that was available to Verizon's and Frontier's Boards of Directors, management, and advisors, as well as subsequently developed data regarding either of the companies, the transaction, and refined projections regarding the post-closing "new" Frontier.

**Q. Have you been able to review all of the information you require?**

A. For the most part, but as I explain later, there are some significant gaps in our knowledge about the proposed transaction. Based on their replies to the CWA's interrogatories, however, it appears that neither company created more than rudimentary sensitivity analyses to test how robust the new combined company would be under various scenarios. In addition, as I discuss below, the key assumption in Frontier's financial model – its projected \$500 million in annual savings from so-called "synergies" -- is not based on detailed Verizon data, but, rather, starts with high level Verizon 2008 operating expense information, which is then projected forward to 2013, based on Frontier's own financial and operating experience and not on any bottom-up analysis of the actual Verizon operations that Frontier proposes to acquire.

Nonetheless, I have been provided with a large amount of public and purportedly confidential information. Based on this data, I am prepared to offer my opinion, although with certain caveats upon which I elaborate below.

**Q. Please summarize the types of documents that you were able to review in this case.**

A. I have reviewed documents that fall into a number of categories:

- Press reports;
- Frontier and Verizon filings with the Securities and Exchange Commission;
- Documents from various public utility regulatory agencies;
- Documents derived from on-line databases;
- Proprietary analyses produced by a number of investment advisory firms;
- Pre-filed testimony from Frontier and Verizon; and,
- Frontier and Verizon responses to numerous interrogatories and requests for production of documents in this case, including a large volume of purportedly confidential documents and information.

**Q. Before addressing details of the transaction, please describe your basic impressions about the proposed Frontier-Verizon transaction.**

A. My overall reaction to the proposed transaction is one of disappointment. This transaction is being driven, in large measure, by the income tax rules. Verizon can make the transaction tax-free to itself and its stockholders only if it finds a buyer that is considerably smaller than the service areas being sold. In effect, a tax-free transaction

194 can only be used if Verizon's stockholders end up owning a majority of the combined  
195 company. Verizon did this once before – with the sale of its landline operations in  
196 Maine, New Hampshire, and Vermont to FairPoint Communications. That deal has been  
197 a disaster for FairPoint, its customers and the communities it serves. On October 26,  
198 2009, FairPoint petitioned for protection under Chapter 11 of the Federal Bankruptcy  
199 Code. FairPoint has not been able to maintain Verizon's service quality or uphold many  
200 of the commitments and other promises it made to regulators and elected officials in those  
201 states. As I describe below, there are now signs that the company will seek the  
202 bankruptcy court's approval to modify the terms established by regulators as part of the  
203 approval process for the transaction.

204         While I am not suggesting that Frontier is FairPoint (though there are unfortunate  
205 similarities, as I discuss below), I would have hoped that Verizon learned its lesson from  
206 the FairPoint debacle and would no longer try to use the tax loophole that makes it  
207 essential that Verizon find a much smaller buyer. Unfortunately, Verizon did not do so  
208 and we now have Frontier – a company with fewer than 2.3 million access lines – hoping  
209 to acquire Verizon business with a total of approximately 4.8 million access lines. Even  
210 worse, Verizon's lines are spread out all over the country – literally from coast to coast –  
211 and many of them are in states where Frontier does not currently operate, or where its  
212 presence is small. For example, in West Virginia, as of December 31, 2008, Frontier had

213 about 144,000 access lines today, but wants to acquire Verizon's business with 617,000  
214 lines in the state.

215 As I explain below, my testimony focuses on my analysis of Frontier's financial  
216 condition, including both its historical and current financial conditions and its projections  
217 for the future, as well as on the risks that I believe this transaction poses to VSTO's  
218 customers, communities and employees.

219 **Q. Based on your review and analysis, are you able to render an opinion about the**  
220 **reasonableness of the companies' financial assumptions and analyses?**

221 A. Yes, I am able to render an opinion. While there is some critically important information  
222 that is missing, I have enough information to conclude that Frontier's current financial  
223 position is precarious, that it has not made reasonable assumptions about the financial  
224 impact of acquiring VSTO, and that Frontier is not financially fit to own and operate  
225 Verizon's business in West Virginia.

226 **CONCERNS WITH FRONTIER AND THE PROPOSED TRANSACTION:**  
227 **UNREALISTIC SAVINGS AND ILLUSORY BENEFITS**

228 **Q. Please provide a broad summary of your analysis.**

229 A. Based on my analysis and as I discuss in greater detail below, the proposed transaction  
230 raises serious concerns about whether the new Frontier will be able to provide quality  
231 telecommunications services and deployment of advanced high-speed broadband  
232 services. Frontier will find it difficult to meet its debt obligations while simultaneously

investing enough capital to maintain current plant, improve service quality, set up entirely new operational, administrative and billing systems in West Virginia, pay to maintain existing computer systems from Verizon in the other 13 states until it integrates those systems, provide video service for the first time, ensure adequate staffing, and expand broadband availability. The financial and operational risks involved in the transaction overwhelm any supposed benefits.

**Q. Frontier has promised benefits from the proposed transaction. Do you agree?**

A. No, I do not agree with Frontier. While I would like to believe the promises of enhanced broadband deployment and better customer service, the financial realities will make it difficult for Frontier to deliver these types of benefits to the public. Frontier will be burdened with an additional \$3.3 billion in debt, and Verizon's transferred properties will experience a six-fold increase in the revenue they must generate to service the higher debt load. Equally disturbing, Frontier has not yet obtained any of the debt financing it requires to complete the transaction. Millions of dollars will leave West Virginia and the other VSTO states to service Frontier's debt and pay its extravagant dividend to stockholders – money that would not be paid out under Verizon's ownership and that could be invested in the telecommunications network.

Further, neither Frontier nor any other company its size has ever taken on a deal of this complexity and magnitude – requiring the integration of 4.8 million lines spread over parts of 14 states stretching from coast to coast. The new Frontier will have to manage a

company with triple its current number of access lines and employees. In West Virginia, Frontier will need to integrate all computer systems – including billing, ordering, provisioning, network operations, trouble reporting, dispatch, customer service, among other systems – on the day the deal closes. In the 13 other states, where Frontier will use a copy of Verizon’s systems (and for which Frontier will pay an annual maintenance fee), Frontier will be under pressure to cut-over to its own systems as soon as possible – and likely before they are ready -- in order to stop paying an annual \$94 million maintenance fee to Verizon, and to meet Frontier’s projected \$500 million annual “synergy” targets.

**Q. Are there benefits that outweigh these risks?**

A. No, there are not. The transaction poses tremendous financial and operational risks of harm, but it presents few countervailing public interest benefits. Frontier has not made any definite, verifiable, or enforceable commitments in terms of broadband build-out or improvements in service to consumers. Frontier projects a 21 percent or \$500 million annual cut in operational expenses,<sup>3</sup> which would further limit funds available for investment in plant, customer service, and staffing. Even without such draconian so-called “synergy” savings, Frontier – a more highly leveraged company than Verizon – will struggle to find the resources to expand and upgrade broadband services.

---

<sup>3</sup> [ <<< **BEGIN CONFIDENTIAL & PROPRIETARY** ]

**END CONFIDENTIAL &**



**Q. What will Frontier do with the profits it hopes to earn from operating VSTO?**

A. Frontier's business model has been based on a transfer of wealth to shareholders rather than re-investment in its networks. Frontier has historically paid out more in dividends to shareholders than it earns in annual profits, and as a result, has seen its shareholder equity steadily decline. Frontier plans to continue this pattern with VSTO.

**Q. Frontier says it has plans for increased broadband investment in VSTO. Do you doubt those promises?**

A. Yes, I do. As Susan M. Baldwin discusses in her testimony, Frontier's historic and projected capital expenditures are less than the level that Verizon actually has been investing in VSTO. And while Frontier claims it has a higher rate of broadband deployment in its service areas than Verizon has in VSTO, Frontier fails to mention that it receives higher per-line universal service support for these areas than Verizon. I am advised by counsel that under the Federal Communications Commission's "parent trap" rule, Frontier's universal service support would be the same as Verizon's in the VSTO service areas.<sup>4</sup>

Based on data supplied by Frontier witness, Billy Jack Gregg, in West Virginia, Frontier received USF support of \$104.18 per access line in 2008, while Verizon received \$45.70. Put another way, USF support represented 5.1% of Verizon's revenues in 2008 while it accounted for 10.7% of Frontier's revenues. According to Mr. Gregg's

---

PROPRIETARY>>>

289 calculations, the combined companies' USF support would have constituted only 6.2% of  
290 total revenues, a much lower level than Frontier has received for its own operations in the  
291 state.<sup>5</sup> In response to another CWA question, Mr. Gregg acknowledged that while "at the  
292 current time USF support cannot be used directly for broadband, the higher level of  
293 support received by Frontier is obviously helpful in upgrading outside plant which can be  
294 used to provision both broadband and basic voice service."<sup>6</sup> Finally, while Mr. Gregg  
295 speculates that the combined companies could reallocate cash flows, including those  
296 derived from universal service support, "from one part of the state to another," he does  
297 not explain how that can be legally accomplished under current USF strictures and he  
298 acknowledges that he has not analyzed any cash flow-impacting expenses associated with  
299 the transaction.<sup>7</sup>

300 So Frontier will not be able to rely on enhanced federal support to enhance  
301 broadband deployment in the VSTO service areas. I have not seen an actual plan by  
302 Frontier that explains how it will invest less than Verizon has been investing in VSTO,  
303 but somehow enhance broadband availability and improve the quality of the network.

304 In fact, the proposed Verizon divestiture to Frontier would most likely represent a  
305 step backward for high-speed broadband deployment in these states. Verizon has

---

<sup>4</sup> 47 CFR § 54.305

<sup>5</sup> Prepared Direct Testimony of Billy Jack Gregg on Behalf of Frontier Communications Corporation, pp. 4, 5 and 9; also see Mr. Gregg's corrected pages 8 and 9 of his testimony, provided in response to CWA 2nd Discovery, response 13.

<sup>6</sup> Response to CWA Second Discovery, response 19.

<sup>7</sup> Response to CWA Second Discovery, response 25.

306 deployed its world-class FiOS fiber-to-the-home (“FTTH”) network in parts of four states  
307 involved in this deal (Washington, Oregon, Indiana, and South Carolina). Today,  
308 Verizon’s FiOS network passes 600,000 homes in these states, and serves 140,000 FiOS  
309 Internet and 103,000 FiOS TV subscribers.<sup>8</sup> (Verizon sells FiOS Internet in all four states,  
310 but does not sell FiOS TV in South Carolina.) Further, in some areas where Verizon has  
311 not yet deployed FTTH, it is offering a high-speed 7 mbps residential DSL service – a  
312 service that, to the best of my knowledge, Frontier does not offer in West Virginia today.

313 In stark contrast to Verizon’s state-of-the-art FTTH network and its progressive  
314 high-speed DSL service, Frontier’s residential customers in West Virginia are limited to  
315 DSL at either 256 kbps, 1 mbps or 3 mbps.<sup>9</sup> I am unaware of any plans that Frontier  
316 might have to improve either its existing network or the VSTO network beyond the 3  
317 mbps DSL service.<sup>10</sup>

318 **FRONTIER LACKS FINANCIAL FITNESS: FRONTIER’S UNSUSTAINABLE, HIGH-**  
319 **RISK BUSINESS MODEL**

320 **Q. Do you have enough information to evaluate the impact of the proposed transaction**  
321 **on Frontier’s financial viability and fitness?**

322 A. No, not entirely. This is a large and complex acquisition. The \$8.4 billion deal will  
323 transfer 4.8 million access lines across 14 states, impact millions of customers and

---

<sup>8</sup> Prospectus, p. 146

<sup>9</sup> Frontier reply to CWA Set 3, Question 10.

<sup>10</sup> In a reply to an IBEW interrogatory in Illinois (IBEW 2.9), Frontier affirmed that it “has no plans to increase

hundreds of communities in Verizon's transferred exchanges and in Frontier's existing territories. Many unanswered questions remain. Specifically, at this date, the Applicants have not provided sufficient information to answer the following questions:

- Will Frontier be able to finance the transaction and what will Wall Street demand to provide the financing? Frontier needs to raise \$3.3 billion, but it does not have a commitment for the financing.
- How will Verizon realign its operations in West Virginia and the 12 other former GTE states to provide the same functions that are currently provided centrally?
- How and when will Frontier integrate Verizon's computer systems and operations in the former GTE states into Frontier's systems and operations centers?
- How will Frontier achieve its promises to expand the level of broadband availability in Verizon's service areas while investing less than Verizon has been investing in the same service areas? Frontier has not provided any state-specific plans, budgets, milestones, or even goals; and to the best of my knowledge, it has not even visited central offices or other facilities in West Virginia or many of the other states it wants to acquire.
- How will Frontier achieve the projected synergy savings of \$500 million per year? Frontier is projecting a 21 percent reduction in VSTO's operating costs, but we do not know how this can be achieved without adversely affecting the quality, safety, and reliability of service it provides to the public.
- Does Frontier have the expertise, capability, and desire to maintain and expand the availability of VSTO's DSL service?
- How will the transaction affect Frontier's existing customers and its ability to expand broadband service to current Frontier areas that are underserved by service that is barely fast enough to meet the FCC's outmoded minimal definition of "broadband?"

In summary, there are many unanswered questions about the proposed transaction. The Applicants implicitly ask the Commission to accept their vague, unverifiable claims at face value. "Trust us" is not enough.

---

speed offerings in its existing Illinois service areas ..." It gave a similar reply in Ohio.

**Q. In your opinion, why is Frontier pursuing such a large transaction?**

A. Frontier is approaching the end of its ability to sustain the high-dividend disinvestment business model it adopted about five years ago. While the company, then known as Citizens Utilities, grew rapidly in the late 1990s and early 2000's, it actually peaked in 2001 (in terms of access lines and shareholder equity) and 2002 (in terms of revenues).<sup>11</sup> Subsequently, it was forced to write down over a billion dollars in assets while it exited the gas, water and electric utility businesses, as well as its CLEC operations. Schedules 1, 2 and 3 clearly demonstrate this situation, over the past ten years, as reflected by Frontier's revenue, access line and property, plant and equipment trends.

**Q. What led Citizens to write down its assets?**

A. In the early part of this decade, Citizens ran into significant financial difficulties, particularly with its CLEC and gas and electric utility operations. In 2002, it booked impairment charges in excess of \$1 billion (\$657 million on its Electric Lightwave CLEC and \$417 million on its gas and electric utility assets). In 2003, Citizens announced that it would explore "strategic alternatives." During 2004, Citizens reportedly had at least two private equity suitors (Kohlberg Kravis Roberts and the Blackstone Group), but the company's board rejected that course. It reinstated its common stock dividend (including a huge special payment to shareholders in 2004) and it appointed Mary Agnes (Maggie)

---

<sup>11</sup> Even though Frontier acquired a reasonably large single-state telecommunications company in 2007 (Commonwealth Telephone Enterprises of Pennsylvania), adding over \$260 million in revenues and some 434,000 access lines, the company's revenues and access line levels have not matched those it achieved at the beginning of the decade.

371 Wilderotter as the company's a new president and CEO (she was named board chair in  
372 2006).

373 After undergoing this financial restructuring, Citizens' board adopted a new high-  
374 dividend, depreciation-driven model. Since then, Citizens (and Frontier since the name  
375 change) has consistently paid out much more to shareholders than it earned in net income.  
376 During 2008, Frontier paid out dividends equal to 174% of net income. In the first half  
377 of 2009, the payout has been 240% of its profits (\$65 million of net income; more than  
378 \$156 million paid in dividends). The result is that Frontier's shareholders' equity has  
379 declined steadily – it stood at almost \$2 billion in 2001, but is now less than \$450 million  
380 (as of June 30, 2009).

381 **Q. Is there something wrong with a utility paying out more in dividends than it earns?**

382 A. Yes, there is. It simply is not sustainable for a public utility to consistently pay out more  
383 to its shareholders than it earns in net income. Counsel informs me that, in rejecting a  
384 proposed acquisition in 2007, the Montana Public Service Commission explained the  
385 reasons why a utility's dividend payments should be less than the utility's net income. In  
386 *NorthWestern Corp.*,<sup>12</sup> the Montana PSC rejected a proposed merger and acquisition,  
387 primarily because of the acquiring company's plan to pay out more in dividends than it  
388 would earn. The Montana PSC explained why this was so problematic for a public

---

<sup>12</sup> 2007 Mont. PUC LEXIS 54 (Mont. PSC July 31, 2007) The order is also available on the Montana commission's web site at: < [http://www.psc.state.mt.us/eDocs/eDocuments/pdfFiles/D2006-6-82\\_6754e.pdf](http://www.psc.state.mt.us/eDocs/eDocuments/pdfFiles/D2006-6-82_6754e.pdf) >. Citations are to the numbered paragraphs in the order, which are the same in either the Lexis or web site versions of the order.

389 utility: “In normal utility operations, retained earnings provide a vital source of financial  
390 strength for capital investment and as reserves that are available during unexpected  
391 financial strains. Regularly paying out dividends in excess of net earnings by a utility is  
392 inappropriate and risky because having insufficient reserves on hand could adversely  
393 affect the utility's ability to provide adequate service.”<sup>13</sup>

394 I completely agree with the Montana PSC’s reasoning. Cash recovered through  
395 customers’ rates for depreciation is supposed to be reinvested in the business, not paid out  
396 to shareholders to pump up the stock price. But that is precisely what Frontier has been  
397 doing, and, based on its public filings, plans to continue to do if this transaction is  
398 approved.

399 **Q. How does the proposed acquisition of VSTO relate to Frontier’s business model?**

400 A. In order for Frontier to sustain its business model, it needs to acquire more customers and  
401 continue to invest far less in the business than it earns. Thus, the proposed acquisition of  
402 VSTO would allow Frontier to keep following its high-dividend, low-investment scheme  
403 for a few more years. At some point, though, Frontier’s model will fail. The company  
404 will run out of retained earnings and will not generate enough cash flow from  
405 depreciation to keep paying exorbitant dividends. Because of the number of shares of  
406 stock Frontier would issue to Verizon stockholders in this deal, Frontier’s next

---

<sup>13</sup> *Ibid.*, para 149.

acquisition would have to be huge – in the tens of millions of access lines – in order to further pursue its failed business model.

**Q. Are you saying that Frontier’s business model is not sustainable?**

A. Yes, that is exactly right. Frontier’s business model is based on high dividend pay-outs, financed by reducing the value of its assets. A company can support this business model over the short-term by adding assets through new acquisitions. But such a model is not sustainable over the long-term, particularly if the company takes on large debt to finance the purchase. This is precisely what Frontier proposes to do in this transaction.

Frontier has consistently paid out much more to shareholders than it has earned in net income. During 2008, Frontier paid out dividends equal to 173 percent of net income. In the first three quarters of 2009, the payout has been 199 percent of profits (\$234 million in dividends, \$118 million in net income). (*See* Schedule 4) The result is that Frontier’s shareholders’ equity has declined steadily. It stood at almost \$2 billion in 2001, but is now less than \$418 million (as of September 30, 2009). During the first nine months of 2009, Frontier's shareholder equity fell 18.9%, or \$100 million.<sup>14</sup>

If a company pays out more in dividends than it earns in profits, there are basically two other sources from which such dividends can be paid: retained earnings and non-cash charges to the income statement. By far the largest non-cash charge for most companies,

---

<sup>14</sup> Frontier SEC Form 10K, filed March 12, 2002, p. F-3 and Frontier SEC Form 10Q, filed November 4, 2009, p. 2



425 including Frontier, is depreciation and amortization (D&A). As can be seen in Schedule  
426 5, Frontier's D&A has been roughly double its capital expenditures.

427 A fundamental result of Frontier's practice of using depreciation-based cash flows  
428 to fund dividends is an inevitable decline in its property, plant, and equipment. Even with  
429 the 2007 Commonwealth Telephone acquisition of 434,000 access lines, Frontier's net  
430 property, plant, and equipment has declined by more than \$1.2 billion dollars since its  
431 peak in 2001. (*See* the previously referenced Schedules 3 and 5) Frontier's business  
432 model is based on failing to adequately reinvest in its network – in essence, cannibalizing  
433 its network assets – to pay high dividends to shareholders.

434 **Q. Do other analysts share your view of Frontier's future?**

435 A. Yes. At the beginning of 2009, Jason Armstrong (a telecommunications analyst from  
436 Goldman Sachs) and Simon Flannery (a telecommunications analyst from Morgan  
437 Stanley) issued independent projections of Frontier. Both analysts projected that  
438 Frontier's shareholder equity would turn negative between 2012 and 2014.<sup>15</sup> As can be  
439 seen in Schedule 6, by November 2009, while these analysts support the transaction with  
440 Verizon, they were also projecting that a standalone Frontier would see its shareholder  
441 equity turn negative in 2012.

---

<sup>15</sup>Goldman Sachs and Morgan Stanley financial models for Frontier Communications, both dated February 25, 2009.

The Morgan Stanley and Goldman Sachs analysts also project a continued decline in Frontier's Net Property, Plant & Equipment, as can be seen in Schedule 7.<sup>16</sup>

**Q. But Frontier projects that this deal would improve the Company's financial condition. Do you disagree?**

A. Yes, I disagree with Frontier's assessment. Frontier's track record for these types of forecasts is not good. The Company had promised Wall Street that the 2007 Commonwealth acquisition would only result in a temporary increase in Leverage Ratio (Net Debt to EBITDA) from 3.1x at year-end 2006 to around 3.6x before declining to pre-transaction levels.<sup>17</sup> In prepared direct testimony before the Pennsylvania Public Utility Commission in connection with the 2006 agreement to acquire Commonwealth Telephone, Frontier executive Daniel McCarthy assured the Commission that an increase in leverage caused by that transaction would only be temporary:

". . . as a result of the acquisition of CTE, Citizens' leverage ratio (net debt divided by earnings before interest, taxes, depreciation and amortization, or EBITDA) will only slightly increase from 3.2 times to 3.5 times. These figures are based on a June 30, 2006 schedule of both companies' publicly disclosed historical results. As such, they do not reflect the synergies I discuss within this testimony, nor do they reflect any operating cash flow realized after June 30. Both of these items will increase our available cash balance, which will reduce our net debt and leverage ratio."<sup>18</sup>

---

<sup>16</sup> Both analysts produce detailed financial projections which they regularly update. As of this writing, the most recent iterations of these models were dated November 4, 2009 and November 11, 2009, respectively, for Goldman Sachs and Morgan Stanley.

<sup>17</sup> "Management expects to be able to bring net leverage from 3.6x to the 3.2x area while concurrently repurchasing equity under its \$250 million stock repurchase plan, . . ." Goldman Sachs, Credit Research (Kevin Coyne), May 2, 2007.

<sup>18</sup> Prepared Direct Testimony of Daniel McCarthy, Executive Vice President and Chief Operating Officer, on behalf of Citizens Communications, November 10, 2006, pp. 12-13.

462  
463 However, by year-end 2008, Frontier's Leverage Ratio stood at 3.8x and was rising.

464 In early 2009, Frontier negotiated an increase in its maximum leverage ratio with  
465 one of its lenders from 4.0x to 4.5x, along with an interest penalty if the leverage ratio  
466 rises above 4.0x (which the Goldman Sachs analyst projects Frontier will exceed by year-  
467 end).

468 Frontier has maintained a high debt level, which has fluctuated somewhat during  
469 this decade, but which currently stands close to its all-time high. The company's  
470 Leverage Ratio (Net Debt to EBITDA) has steadily risen from 3.1x in 2006 to around  
471 4.1x as measured on September 30, 2009. When it acquired Commonwealth Telephone,  
472 Frontier projected that this would not occur, but the Company was dead wrong. As can  
473 be seen in Schedule 8, the Morgan Stanley and Goldman Sachs analysts have projected  
474 that, standing alone, Frontier would breach the 4.5x Leverage Ratio maximum  
475 somewhere between 2013 and 2014.

476 As can be seen in Schedule 9, the two analysts also project that Frontier's current  
477 trajectory would lead it to paying out dividends (at its current \$1 per share level) that  
478 exceed its Free Cash Flow by 2014. These are all signs that Frontier's business model is  
479 not sustainable. The Company is engaged in a high-risk path to financial failure and soon  
480 will be forced to drastically reduce its dividend and cut back further on its capital  
481 expenditures. Its only alternatives are to merge with a larger company (which would be  
482 likely to result in Frontier's management losing their jobs) or buying millions of

additional customers – and the cash flow they provide – to avert failure for a few more years. In my opinion, that is what is motivating Frontier to pursue the proposed deal with Verizon.

**Q. Are there indications that Verizon understood Frontier’s true motivations for this deal?**

A. Yes, there are. In an internal email message on April 19, 2009, the head of Verizon’s negotiating team, Verizon Vice President of Business Development for the Domestic Telecommunications group, Stephen Smith, wrote to other members of the Verizon team:

**<<<BEGIN CONFIDENTIAL & PROPRIETARY**

**END CONFIDENTIAL & PROPRIETARY>>>**

**Q. Have you seen this type of high-dividend, low-reinvestment business model before?**

A. Yes, I have. FairPoint Communications was engaged in the same type of scheme before its deal with Verizon was announced. FairPoint’s financial condition was precarious because of the same strategy Frontier is pursuing: use the cash flow to pay out dividends far in excess of profits, under-invest in the networks, don’t retain cash in the business, and acquire new customers (and their cash flows) every few years to prop up the business. In fact, it was in my testimony in the FairPoint cases that I first referred to this process as “cannibalizing” the business – failing to reinvest enough in the business to offset the

---

<sup>19</sup> Email message from Stephen E. Smith to John W. Diercksen, Jackson G. Bennett, John P. Fitzgerald, dated April

504 depreciation of current property, which reduces net plant and continually erodes retained  
505 earnings.

506 FairPoint needed a big acquisition to sustain its scheme for a few more years. It  
507 purchased Verizon's lines in Maine, New Hampshire, and Vermont – roughly increasing  
508 the size of FairPoint six-fold (from 300,000 access lines to approximately 1.8 million  
509 lines). To do so, FairPoint took on an extraordinary amount of debt, some of which  
510 carried very high interest rates. But FairPoint believed that there was sufficient cash flow  
511 in the Verizon businesses to allow it to sustain its high-risk business model.

512 Frontier is larger than FairPoint was – it is a little further along on the curve of  
513 buying more customers (and their cash flows) to sustain the scheme – but the strategy is  
514 exactly the same. And this deal is needed by Frontier for exactly the same reasons that  
515 FairPoint needed to do its deal with Verizon.

516 **Q. What happened to FairPoint?**

517 A. Unfortunately, FairPoint got trapped by its model. Just as the Montana commission  
518 warned in the order I cited above, when a utility fails to retain sufficient cash in the  
519 business, it cannot weather an economic downturn or other unforeseen circumstances.  
520 After it acquired Verizon's lines, FairPoint experienced a combination of the economic  
521 downturn, service quality problems, and the resulting customer dissatisfaction. As I had  
522 warned, FairPoint's revenue projections were unjustifiably rosy, it had insufficient cash

---

19, 2009 (document 4(c)(42) attached to Verizon's Hart-Scott-Rodino filing).

523 flows and reserves to reliably operate the business, and it was unable to generate the  
524 revenues it needed to pay its lenders – let alone pay any dividends to stockholders.

525 At the end of September 2009, FairPoint announced that it was unable to make the  
526 required payments on its debt, but that it received a 30-day reprieve from some of its  
527 lenders. As I mentioned above, the company entered Chapter 11 bankruptcy on October  
528 26, 2009. FairPoint also filed a "Plan Term Sheet" for a reorganization plan that it had  
529 agreed upon with a "steering committee" of its secured creditors. This plan provides for,  
530 among many other things, the conversion of more than half of the company's secured  
531 loans into a 98% equity ownership stake in a reorganized FairPoint (assuming, of course,  
532 such a plan is ultimately approved by the Bankruptcy court). Beyond turning the  
533 company's secured lenders into its new owners, the Term Sheet contains a provision that  
534 appears to challenge the enforceability of public utility commission penalties or fines:

535 "The allowance of unsecured claims and the treatment of unsecured claims . . .  
536 including any claims held by state public utility commissions relating to the NNE  
537 [FairPoint Northern New England] Operating Companies' alleged failure to  
538 satisfy certain service quality indicators, shall be determined at a later date *on*  
539 *terms reasonably satisfactory to the Steering Committee Lenders and the*  
540 *Company.*"<sup>20</sup> [emphasis added]

541 It also appears that FairPoint may call into question the various broadband  
542 expansion commitments it made to regulators in the three Northern New England states  
543 in order to obtain approvals for the acquisition of Verizon's landline assets. In a  
544

---

<sup>20</sup> Declaration of Alfred C. Giammarino Pursuant to Rule 1007-2 of the Local Bankruptcy Rules for the Southern District of New York in Support of First-Day Motions; Exhibit B, "Plan Term Sheet," Section 6(d).

Telephony Online article entitled "Fairpoint aims to renegotiate broadband rollout requirements," reporter Ed Gubbins writes that "Fairpoint's lawyers are currently examining whether or not its Chapter 11 protection from creditors might also allow the company to renegotiate regulatory requirements in Vermont, New Hampshire and Maine, where it acquired 1.7 million access lines from Verizon." As Gubbons reports,

"As part of the regulatory approval process for its Verizon deal, Fairpoint had to commit to spending set amounts on broadband expansion in all three of the states involved. In Maine, it was required to spend an average of \$47 million on broadband expansion during the first three years following the deal. In Vermont, it was required to spend an average of \$40 million per year in the first three years. And in New Hampshire, it was required to spend at least \$52 million in each of the first three years and \$49 million in each of the two years after that; Verizon contributed \$49.2 million to that effort, but this year the state allowed Fairpoint to use Verizon's contribution for general purposes."<sup>21</sup>

**Q. Frontier claims that it is not like FairPoint and that this transaction will make it stronger and even allow it to approach an investment-grade bond rating. How do you respond?**

A. FairPoint made very similar assertions, trying to assure us that it would be a financially strong company if only it could do this next deal. Despite Frontier's assertions to the contrary, FairPoint also presented the transaction as *delevering*. On a pro forma basis, FairPoint projected that its Leverage Ratio would decline from 4.5x to 4.1x at closing.<sup>22</sup> But a dispassionate view of the numbers did not support FairPoint's belief and it does not

---

<sup>21</sup> Telephony Online, October 26, 2009, <http://www.telephonyonline.com/independent/news/fairpoint-renegotiate-broadband-102609/index.html> (accessed October 27, 2009)

<sup>22</sup> FairPoint Communications SEC Form 8-K, January 16, 2007, page 12 of the attached investment analyst presentation. In fact, because of actions by regulators which effectively reduced the price FairPoint paid, and thus

568 support Frontier's belief either. It is possible that the transaction may help Frontier for a  
569 little while. As I explained, Frontier is on the path to failure, and this deal may help avoid  
570 that result for a few years. I am concerned, however, that there is no certainty in that  
571 result. This is especially true because Frontier's debt burden will increase by \$3.3 billion,  
572 to more than \$8 billion overall, if this deal goes through.

573           Frontier argues that the deal will make it finally stronger by reducing its leverage.  
574 But that calculation is based on unsubstantiated and unrealistic assumptions about  
575 revenues and expense savings, none of which are certain (or even likely) to occur. What  
576 will be certain, however, is that Frontier's debt burden will nearly double and Wall Street  
577 lenders will need to be paid out of an ever-shrinking pool of revenues. I am especially  
578 cautious about believing Frontier's rosy projections because it made similar projections  
579 before the Commonwealth Telephone deal that did not pan out, as I discussed above.

580 **A FRONTIER ACQUISITION WOULD SIGNIFICANTLY WEAKEN VSTO**  
581 **(VERIZON'S OPERATIONS IN WEST VIRGINIA AND 13 OTHER STATES)**

582 **Q.     What effect would the proposed transaction have on the financial condition of**  
583 **VSTO, including current Verizon operations in West Virginia?**

584 A.     In my opinion, this is the critical question. While the deal may help Frontier somewhat, I  
585 believe that the Commission's primary concern should not be whether the deal would  
586 help Frontier, it is whether it will help VSTO – that is, existing Verizon customers and

---

the debt it was required to incur, its Leverage Ratio, on the same pro forma basis, was actually 3.8x at closing.



587 the communities they serve. In my opinion, the answer to that question is unequivocal:  
588 there is no doubt that this transaction would make VSTO significantly weaker financially.

589 Right now, VSTO has only about 34 cents in debt for every dollar of operating  
590 cash flow. After the Frontier deal closes, these same properties (previously owned by  
591 Verizon) will be responsible for at least \$2.60 in debt for every dollar of operating cash  
592 flow, an increase of over 600 percent. (*See* Schedule 10). The divested Verizon properties  
593 will be tied to a company with much lower profits and much higher debt service  
594 requirements – a combination that results in a much lower margin for error and much less  
595 ability to weather unexpected negative conditions (such as service quality problems,  
596 increased competition from cable companies and other carriers, economic downturns in  
597 portions of the service area, or new technologies that make existing services obsolete).

598 Specifically, during the first quarter of 2009, Frontier reported profit margins of  
599 6.7 percent compared to a 16.5 percent profit margin for VSTO. For the first half of  
600 2009, the difference narrowed somewhat, but VSTO still had a profit margin almost  
601 double that of Frontier (11.4% versus 6.1%).<sup>23</sup> At this writing, VSTO's 3rd quarter  
602 results have yet to be made available, but Frontier's profit margin for the first nine months  
603 of 2009 were 7.4%.

604 In addition, Frontier has not yet obtained any of the approximately \$3.3 billion in  
605 debt financing for the proposed transaction. The merger agreement permits Frontier to

---

<sup>23</sup> Prospectus, pp. 16 and 19.

606 walk away from the deal if it cannot obtain that financing at an annual average interest  
607 cost of 9.5 percent or less (including the original issue discount).<sup>24</sup> Frontier's recent debt  
608 has high interest rates and it just issued \$600 million in securities at an effective rate of  
609 about 8.73 percent to pay off near-term notes.<sup>25</sup> The next most recent debt was issued on  
610 April 9, 2009, and carries an annual interest cost of 10.375 percent. Around the time of  
611 the transaction, Frontier's bonds traded in the range of 7.51 percent to 12.56 percent  
612 depending on the term, with most in the 9 to 11 percent range.<sup>26</sup> More recently, Frontier's  
613 issues traded in the 6% to 11% range, mostly between 8% to 9%. In the current unstable  
614 economic environment combined with Frontier's recent cost of debt, it is not clear that  
615 the company will be able to finance this transaction on reasonable terms. It is possible  
616 that Frontier – and the public it serves – may be saddled with extraordinarily high debt  
617 costs or other onerous conditions that lenders may require. Frontier's Chief Financial  
618 Officer has stated that he does not expect even to begin the process of obtaining this  
619 financing until January 2010 and that he does not expect to have financing in place until  
620 March or April 2010.<sup>27</sup>

---

<sup>24</sup> Agreement and Plan of Merger between Verizon and Frontier, dated as of May 13, 2009, § 7.18(e)(ii).

<sup>25</sup> The \$600 million issue, which matures on October 1, 2018, carries a coupon of 8.125%. Frontier's net proceeds were \$577.6 million, after discounts and expenses, yielding an effective interest rate of 8.73%, Frontier SEC Form AWP, September 17, 2009.

<sup>26</sup> Frontier response to Staff data requests 77 and 79 in the Oregon Docket, July 2, 2009; additional trading data obtained from <http://www.investinginbonds.com>.

<sup>27</sup> Transcript of Frontier analysts' conference call, Aug. 4, 2009, p. 12.

621 **Q. Can you determine the financial impact of this deal on VSTO and Frontier without**  
622 **knowing the terms of that financing?**

623 A. No, because of Frontier's current precarious financial condition, it is not possible for me,  
624 or any other independent financial analyst, to know whether Frontier will be financially  
625 viable (and for how long) without knowing the interest rate and other terms and  
626 conditions of that financing.

627 **Q. Frontier has announced that it would reduce its dividend if this deal goes through.**  
628 **Have you taken that into account in your analysis?**

629 A. Yes, I have. Frontier has stated that, if the deal goes through, it would reduce its per-  
630 share dividend pay-out by one-fourth, from \$1 to 75 cents per share annually.<sup>28</sup> Even  
631 with this dividend reduction, it is likely that Frontier would still end up paying far more in  
632 dividends than it earns in profits. Depending on the price at which Frontier's stock is  
633 issued to Verizon's shareholders, Frontier's new dividend would represent between 125  
634 percent and 142 percent of the combined company's (Frontier + VSTO) 2008 net income.  
635 (See Schedule 11) And since net income is likely to decline in the future because of the  
636 large debt burden being taken on by Frontier, these numbers will get even worse.

---

<sup>28</sup> Frontier SEC Form 425, filed May 13, 2009, p. 7.

**Q. Do Verizon and VSTO also pay out more in dividends than they earn?**

A. No. Both Verizon and VSTO have paid dividends that are well below their profit levels.<sup>29</sup> (See Schedule 12) VSTO has been doing what a utility is supposed to do: reinvesting earnings in the business, keeping cash available to maintain flexibility, paying a reasonable dividend to stockholders, and growing retained earnings.

**FRONTIER'S HIGHLY AGGRESSIVE AND UNREALISTIC FINANCIAL PROJECTIONS RISK OVERESTIMATING FUTURE REVENUES AND UNDERESTIMATING FUTURE EXPENSES, POSSIBLY BY SIGNIFICANT AMOUNTS**

**Q. Have you reviewed Frontier's financial projections?**

A. Yes, I have.

**Q. Please summarize your conclusions from conducting that review.**

A. Frontier's financial projections are quite aggressive and are based on a range of unrealistic assumptions. Its revenue assumptions fly in the face of recent experience at both Frontier and VSTO. They are also very risky, in the context of the continued declines in the landline business, heightened broadband competition, and the ongoing uncertainty about the direction of the economy. There is a real risk that Frontier could fall far short of its financial goals and, as a result, be unable to meet many of the commitments it has already made or likely will make during the regulatory process

---

<sup>29</sup> Since VSTO has only recently been created, it obviously did not pay dividends directly to Verizon shareholders. We use VSTO's reported "parent funding, allocations, intercompany reimbursement" as the closest measure available for VSTO's dividend-like "upstream" payments.

656 attendant to this transaction. As I discuss below, Frontier's expense assumptions are  
657 literally unprecedented. The combination of the very risky revenue *and* expense  
658 projections upon which Frontier has built its plans could prove quite toxic.<sup>30</sup> In my  
659 opinion, the Commission should not accept these projections as an accurate baseline to  
660 evaluate the Applicants' pro forma financial projections.

661 **Q. Why do you conclude that Frontier has over-stated its projected revenues?**

662 A. Frontier's so-called "proforma" projections rely on VSTO's year-end 2008 results. But  
663 Frontier recently acknowledged (in its second quarter conference call with investment  
664 analysts) that VSTO lost 136,000 access lines (2.9 percent of all its lines) during just the  
665 second quarter of 2009. Since June 30, 2008, VSTO has lost more than 11 percent of its  
666 access lines, resulting in a significant decline in revenues, cash flow, and net income.<sup>31</sup>  
667 The difficulties that both Frontier and VSTO have been encountering have been  
668 dramatically reflected in their financial results. Below is a table that reflects the  
669 comparative results of both companies during the first half of 2009 ("1H09") compared to  
670 those of the same period in 2008 (as noted earlier, VSTO's 3rd quarter results have not  
671 been made available at this writing). Both Frontier and Verizon suffered in excess of 5  
672 percent revenue declines, big drops in EBITDA (essentially cash operating profits before

---

<sup>30</sup> In addition, while interest rates have declined somewhat since the transaction was agreed upon in May, the economic environment is still quite unsettled and the high yield bond market notoriously volatile and unpredictable, particularly in connection with large, highly leveraged transactions. As noted above, during 2009, many of Frontier's issues have traded over 10%, some over 11% or higher.

<sup>31</sup> Prospectus, p. 146.

taxes and interest), and approximately one-third lower profits. It is very much worth noting that both not only struggled with declining revenues, they obviously had real difficulties controlling costs in this challenging environment: Frontier barely reduced expenses even though its revenues dropped appreciably, and VSTO's costs climbed almost as much as its revenues declined. To say the least, these dynamics do not portend well for Frontier's ability to achieve unprecedented levels of cost savings while attempting to maintain revenues well above either its or VSTO's trend lines.<sup>32</sup>

	Frontier 1H09 vs 1H08	VSTO 1H09 vs 1H08
Revenues	-5.4%	-5.8%
Operating Expenses	-1.4%	4.1%
EBITDA	-10.6%	-18.6%
Net Income	-36.6%	-29.3%

Recently, Frontier stated in its Prospectus filed with the Securities and Exchange Commission, "The combined company will likely face further reductions in access lines, switched access minutes of use, long distance revenues and federal and state subsidy revenues, which could adversely affect it."<sup>33</sup> But Frontier has not revised its financial projections to reflect this view of the future.

There is another aspect of Frontier's projections that concerns me: its implicit assumption that it will be able to dramatically increase broadband penetration in the

---

<sup>32</sup> Prospectus, p. 16 and 146.

<sup>33</sup> Prospectus, p. 29.

688 VSTO territories. As I pointed out earlier, Frontier would seem to be able to afford  
689 higher levels of capital expenditures on broadband, all other things being equal, due to its  
690 much higher USF support and the fact that it can more readily be applied to upgrades of  
691 its copper-based plant. As I explain below in a confidential section of my testimony,  
692 Frontier simply assumes one set of revenue projections for VSTO, which presumably  
693 reflect the company's embedded assumptions regarding increased broadband revenues. I  
694 am concerned that Frontier is applying its experience in its current properties to the  
695 VSTO properties that it seeks to acquire, even though the latter operates in less rural areas  
696 and is subject to more vigorous broadband competition. Mr. Gregg, in his testimony, says  
697 that "it is possible" that Verizon faces more cable broadband competition than Frontier.  
698 In response to a CWA question, he reiterates "to the extent that Verizon serves more  
699 urban areas in West Virginia than Frontier, it may face more competition from cable  
700 companies in those urban areas."<sup>34</sup> Despite Mr. Gregg's reticence, it seems clear that  
701 Frontier's West Virginia operations are significantly more rural, and have significantly  
702 less broadband competition, than does Verizon. While I have not seen Frontier's detailed  
703 revenue projections for VSTO's West Virginia operations (or for any of the Verizon  
704 properties for that matter), I am concerned that Frontier's optimism about its ability to  
705 increase broadband penetration to levels that approach its own has distorted its revenue  
706 projections.

---

<sup>34</sup> Response to CWA Second Discovery, response 24.

**Q. Why do you conclude that Frontier has understated its projected expenses?**

A. It is unprecedented to have expense savings of the magnitude projected by Frontier for a transaction of this size. Frontier projects that it will be able to cut VSTO's annual operating expenses by \$500 million (21 percent of total VSTO expenses) by 2013. In order to achieve savings of this magnitude, Frontier will need to reduce the VSTO workforce and cut deeply into other costs. By comparison, when FairPoint purchased Verizon's access lines in Maine, New Hampshire, and Vermont, FairPoint projected reducing costs by 8 percent to 10 percent (and FairPoint has not been able to achieve even those savings). The most recent major merger involving rural landline operations, the CenturyTel-Embarq transaction, entailed projected synergy savings of 9 percent of Embarq's expenses. (See Table 1). Frontier's so-called synergy savings are either wishful thinking, or will require such draconian reductions in service, workforce, and maintenance that Frontier will not be able to deliver on its promises to improve service and broadband deployment.

**Table 1. Projected "Synergies" from Three Transactions**

	FairPoint- Verizon	CenturyTel- Embarq	Frontier- Verizon
<b>Projected "Synergy" Savings as a % of the Target's Operating Expense</b>	<b>8-10%</b>	<b>9%</b>	<b>21%</b>
Sources: FairPoint SEC Form 8-K, January 16, 2007, 3rd page of press release; CenturyTel SEC Form 8-K, October 27, 2008, 2nd page of press release; Frontier SEC Form 8-K, May 13, 2009, p. 15.			

<<<BEGIN CONFIDENTIAL & PROPRIETARY



Direct Testimony of Randy Barber  
Case No. 09-0871-T-PC

[REDACTED]

[REDACTED]

[REDACTED]

727 [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

739 [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

742 [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

756 [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

760 [REDACTED]

---

<sup>35</sup> The references for Schedules HC-1, -2, and -3 appear on the documents themselves. Also, there is something of a discrepancy between the publicly announced synergies projection of 21 percent and the percentage reflected for the public "guidance" on this transaction. The difference is probably due to slight methodological variations.

[REDACTED]

[REDACTED]

[REDACTED]

764 [REDACTED]<sup>36</sup> END

765 **CONFIDENTIAL & PROPRIETARY>>>**

766 **Q. What is the magnitude of the workforce reduction Frontier projects for VSTO?**

767 A. At the present time, VSTO has approximately 10,700 employees.<sup>37</sup> Frontier projects that  
768 by 2013 VSTO will have only <<<**BEGIN CONFIDENTIAL & PROPRIETARY**

769 [REDACTED]<sup>38</sup> END

770 **CONFIDENTIAL & PROPRIETARY>>>**

771 **Q. Hasn't Frontier promised that none of the job losses will be in service-affecting**  
772 **positions?**

773 A. No, Frontier has not promised that. Frontier has said that it would not lay off any  
774 technicians or installers for 18 months after closing, which would be roughly through the  
775 end of 2011. After that point, Frontier has made no commitments whatsoever to keep its  
776 workforce appropriately sized so that customer service will be maintained and improved.  
777 Moreover, Frontier has yet to respond to multiple queries about its commitment to

---

<sup>36</sup> "WV CWA Set 1\_VZ10 Attach2 Barclays and JPMorgan VZ BoD Prese.pdf," page 14.

<sup>37</sup> Prospectus, p. 32.

<sup>38</sup> See WV CAD Set4 FROM27 att1 Synergy HIGHLY CONFIDENTIAL.pdf and WV CAD Set4 FROM36 att1 Synergy HIGHLY CONFIDENTIAL.pdf, which are the same file. Also see various versions of the Synergy

employees who are **not** technicians or installers. Given the magnitude of the workforce reduction that is contained in Frontier's synergies model, it appears likely that service-affecting jobs (such as call center, customer service, dispatch, and field employees) will be affected.

**Q. Can you show specifically where Frontier has been too optimistic in its expense projections?**

**A. <<<BEGIN CONFIDENTIAL & PROPRIETARY**

---

Process Summary document such as WV CWA Set4 FRO12 Synergy Process Summary highly confidential.pdf.

END CONFIDENTIAL &

**PROPRIETARY>>>** In a summary overview of the company's synergy projection process, Frontier says:

Frontier was provided summary financial and operational information for the FYs 2006 – 2008, by Verizon, relating to Verizon's Wireline operations in 13 states (SpinCo, or the potential divestiture properties) (financial information for California was provided later, but is not material to the forecasts). Frontier identified the various components of the business (local, long distance, and data services) that would be acquired as part of the transaction and generated a historical and forward looking view of revenues and product units by state for the SpinCo properties.

Using this revenue and unit information, and the underlying metrics of demand activity that were available in the data room and via discussions with Verizon personnel, Frontier compared its stand-alone operating performance metrics to the projected view of SpinCo for the FY 2013 and had our functional area teams develop a view of incremental headcount, wage expense . . . and non-wage expenses . . . necessary to operate the acquired properties at current Frontier stand-alone performance levels. . . .

***Due to the nature of the data provided, synergy estimates by functional area and by state were unable to be created.***

Additionally, the calculation of synergies used numerous estimates and assumptions which have yet to be validated by supporting documentation from Verizon. ***No information regarding Verizon's "realignment" plan was provided prior to the determination of the anticipated value of the synergies.***<sup>39</sup>  
[emphasis added]

<sup>39</sup>Frontier supplemental reply to Illinois IBEW 5.12(c), "SynergydocsPUBLIC.pdf" which is the public version of "WV CWA Set1 FTR 34 Frontier Synergy Summary HIGHLY PROPRIET.pdf" and a number of other confidential documents produced by Frontier in this case.

828  
829 <<<BEGIN CONFIDENTIAL & PROPRIETARY  
830

[REDACTED]

836 [REDACTED]

[REDACTED]

845 [REDACTED]

[REDACTED]

847 [REDACTED]

848 END CONFIDENTIAL & PROPRIETARY>>>

**Q. You cite Frontier's description of how its synergies projections were determined. Have you had a chance to evaluate any more detailed explanation of Frontier's synergies analysis?**

**A.** Yes I have. In analyzing the credibility of Frontier's synergies projections, it is important to understand how these projections were created. Frontier received public financial data for 2006-2008 and validated this data through visits to a "data room" and conversations with Verizon personnel. However, in projecting VSTO's synergies under Frontier's management, the company took the 2008 VSTO cash operating expense data, projected it forward to 2010, using that as the starting point for its "final" synergies estimate for 2013. Describing confidential pages of the synergies overview document, Frontier says that

[it] did not take any steps to convert the operating expense "summary buckets" into Departmental categories as reflected on the third and fourth pages of this document. Due to the nature of the data provided, synergy estimates by functional area and by state were not created. Rather, pages 3 and 4 were developed based upon Frontier's current organization and cost structure applied to the business to be acquired. The information received from Verizon was used only in total to create a starting point to determine amount of potential synergies.<sup>40</sup>

**<<<BEGIN CONFIDENTIAL & PROPRIETARY**

[REDACTED]

[REDACTED]

[REDACTED]

<sup>40</sup> Frontier response to Oregon IBEW Data Request No. 249, August 25, 2009.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

882 [REDACTED]

[REDACTED]

884 [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

891 [REDACTED]



**END CONFIDENTIAL & PROPRIETARY>>>**

**Q. You question Frontier's revenue and expense projections. Are you suggesting that Frontier does not have a good understanding of what it would take to operate the VSTO business?**

**A.** Yes, that is exactly what I am saying. This transaction is unprecedented in scope and size. Neither Frontier nor any other company its size has ever taken on a deal of this complexity and magnitude which includes integrating approximately 4.8 million access lines spread over parts of 14 states stretching from coast to coast. As a result of this transaction, the new Frontier will have three times as many access lines (from 2.2 million access lines now to 7 million after the sale) and employees (from 5,400 employees now to approximately 16,000 after the sale).<sup>41</sup>

This deal is at least four times larger than any other Frontier acquisition. Frontier's biggest deal prior to this one was the 2001 acquisition of Global Crossing's telephone landline assets, including Rochester Telephone. That acquisition totaled approximately one million lines but about 70 percent of those lines were located in one state.

It does not appear that Frontier has engaged in rigorous due diligence of the service areas it is acquiring. The period between Frontier's initial meeting with Verizon

---

<sup>41</sup> Prospectus, pp. 11, 32, and 112.

910 to the signing of the merger agreement was only two months.<sup>42</sup> That is an extremely short  
911 period of time to evaluate and plan for a transaction of this complexity and magnitude. It  
912 is not at all clear that Frontier understands the condition of the networks that it proposes  
913 to purchase, the reason broadband deployment lags behind levels in other locations, the  
914 quality of Verizon's equipment and facilities, the availability of spare parts for Verizon's  
915 aging equipment, and numerous other factors that will affect Frontier's ability to offer  
916 quality service and deploy broadband in West Virginia and the remainder of the 14-state  
917 territory.

918 In my role as financial expert for the IBEW and CWA during the regulatory  
919 process in Maine, New Hampshire and Vermont concerning the FairPoint/Verizon  
920 transaction, I performed a series of in-depth analyses of multiple iterations of FairPoint's  
921 transaction model. While I cannot disclose any details (which are also confidential and  
922 proprietary), I can attest that a key difference between FairPoint's model and Frontier's  
923 "proforma" model is that the former relied on detailed historic Verizon revenue and  
924 operating expense data.

---

<sup>42</sup> See Prospectus, pp. 46-54. It is also instructive to evaluate the context in which the Verizon transaction unfolded. Approximately one month prior to the first meeting between the CEOs of Frontier and Verizon, Frontier received an offer to be acquired by "Company A," which Frontier appears to have rebuffed. During the period that Frontier and Verizon were negotiating the present transaction, Company A's CEO periodically contacted Frontier's CEO, seeking to recommence discussions about a potential acquisition of Frontier by Company A. Three days before the Verizon deal was completed, Company A reasserted its offer to purchase Frontier and did so again on the day the Verizon transaction was agreed upon. It is difficult to avoid the conclusion that Frontier rushed into the VSTO transaction in order to escape the clutches of Company A. <<Begin Confidential & proprietary [REDACTED] End Confidential & proprietary>>

While I found many of FairPoint's assumptions and projections to be unrealistic, they were far more grounded in an understanding of the actual Verizon operations than is the Frontier model. Frontier's model is based on Frontier's experience with its own operations and not on Verizon's functions and operations. FairPoint's model contained bottoms up revenue and expense projections based on historic Verizon experience in the Northern New England states. In contrast, Frontier's model contains revenue and expense projections based on Frontier's experience in other parts of the country.

**FRONTIER PLANS TO REDUCE CAPITAL EXPENDITURES**

**Q. Have you reviewed Frontier's projected levels of capital investment in West Virginia and the other VSTO states?**

A. I have reviewed capital expenditure projections at a summary level for the 14 VSTO states. Frontier has not provided specific capital expenditure projections for West Virginia. In reply to a CWA data request Frontier indicates that it "has not completed specific timeline for incrementally increasing broadband availability in the acquired properties in West Virginia" and it "has not developed a cost estimate for deploying additional High-speed Internet services in West Virginia."<sup>43</sup>

**<<BEGIN CONFIDENTIAL & PROPRIETARY**

<sup>43</sup> Reply to CWA Set 3 Data Request, Question 25 a. and b.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

951 [REDACTED]<sup>45</sup> **END CONFIDENTIAL &**

952 **PROPRIETARY>>**

953 **Q. Please summarize your understanding of Frontier’s and VSTO’s current practices**  
954 **regarding the use of their cash flows and capital investment.**

955 A. As I mentioned earlier, Frontier uses an inordinately high amount of its cash flow to pay  
956 dividends to stockholders. Several financial measures capture the amount of cash flows  
957 that a company re-invests in capital projects. One measure evaluates the proportion of  
958 depreciation and amortization (D&A) cash flows that are reinvested as capital  
959 expenditures. Using this measure, VSTO has invested a significantly greater percentage  
960 in new capital expenditures than Frontier every year since 2006. In 2008, VSTO invested

---

<sup>44</sup> “WV CAD Set4 FROM27 att5 BoDProjNor5-1[1] HIGHLY CONFIDENTIAL.PDF ” p. 19; materials prepared by Citigroup and Evercore.

<sup>45</sup> “WV CWA Set 1\_VZ10 Attach2 Barclays and JPMorgan VZ BoD Prese”

twice as much of its D&A derived cash flows in capital expenses (96.2 percent for VSTO compared to 50 percent for Frontier). In 2007, VSTO capital expenditures were one-third larger than Frontier's (88.3 percent for VSTO's compared to 57.9 percent for Frontier), and in 2006, they were 25 percent greater (VSTO's 77.4 percent compared to Frontier's 56.4 percent). (See Schedule 13.)

One can also measure a company's level of capital expenditures as a percentage of its revenues. Frontier makes much of the fact that it dedicates about 12 percent of its revenues to new capital expenditures.<sup>46</sup> However, an examination of the capital expenditures in VSTO reveals a materially higher ratio of capital expenditures in recent years. For the period 2004 through 2008, Frontier dedicated between 12.8 percent and 13.9 percent of its revenues to capital expenditures (It was 12.9 percent in 2008). VSTO, on the other hand, invested 13.5 percent of its revenues in capital expenditures in 2004, increased that proportion to 15 percent or more during 2005 through 2007, and further increased it to 16.8 percent in 2008. (See Schedule 14)

**Q. Does Frontier plan to maintain VSTO's level of capital investment?**

A. No, it does not. Despite its promises of enhanced services and network modernization, Frontier actually plans to reduce VSTO's level of capital expenditures. In 2008, VSTO

---

<sup>46</sup> For example, speaking at the May 18, JPMorgan Global Technology, Media and Telecom Conference, Frontier Chairman and CEO Maggie Wilderotter made the point that she and other Frontier executives frequently repeat: "The other thing that I would add is, if you look at our percentage of revenues that we spend on capital today, it's about 12%. So, for our business as usual, it's probably 4% higher than what Verizon looks at as business as usual." Thompson StreetEvents Transcript, p. 8.

had actual capital expenditures of \$730 million.<sup>47</sup> In fact, from 2005 through 2008, VSTO's capital spending was higher than \$700 million in every year, ranging from \$702 million in 2006 to \$733 million in 2005.<sup>48</sup>

But Frontier does not plan to maintain this level of capital spending. According to Frontier's financial model, it plans to have capital expenditures of <<<BEGIN

**CONFIDENTIAL & PROPRIETARY** [REDACTED]

[REDACTED] **END**

**CONFIDENTIAL & PROPRIETARY**>>>.<sup>49</sup> Moreover, these significant reductions in capital expenditures are occurring during the period when Frontier claims that it will be increasing investment to improve the level of broadband deployment in West Virginia and other VSTO service areas.

Unfortunately, after 2012, Frontier proposes to make even more drastic cuts in the level of capital investment in West Virginia and the other VSTO service areas. Frontier's financial model shows capital expenditures of <<<BEGIN **CONFIDENTIAL & PROPRIETARY** [REDACTED]

---

<sup>47</sup> Prospectus, p. 19.

<sup>48</sup> *Id.*

<sup>49</sup> Frontier proforma financial model. While this spreadsheet is named "WV CWA Set 1 FTR 37 Frontier Synergy Spreadsheet HIGHLY PROP.xls," it is not the Frontier synergies spreadsheet (which was only produced in a highly cumbersome 346 page printout (see "WV CAD Set4 FROM27 att1 Synergy HIGHLY CONFIDENTIAL.pdf" and "WV CAD Set4 FROM36 Synergy spreadsheet HIGHLY PROPRIETARY.pdf."

994

995 **END CONFIDENTIAL & PROPRIETARY>>>.**

996 **Q. What would happen to Frontier's financial condition if it maintained the same level**  
997 **of capital spending (approximately \$700 million per year) that Verizon has**  
998 **consistently invested in the VSTO states?**

999 A. If Frontier continued Verizon's historic \$700 plus million per year of capital spending  
1000 (above and beyond whatever transaction and transition-related costs that it may incur),  
1001 something would have to give. Again, assuming that Frontier maintained a robust capital  
1002 investment program (which could well require more than the Verizon status quo level), it  
1003 would only have one realistic choice: reduce its dividends materially and refrain from  
1004 reinstituting its share repurchase program. The amount that dividends would need to be  
1005 reduced would depend on the specific circumstances of VSTO (and Frontier) when such a  
1006 decision is made. It would be a significant amount, though.

1007 **Q. Have you identified other risks associated with this proposed transaction that could**  
1008 **have negative financial consequences?**

1009 A. Yes. I believe that the requirement for a "flash" cutover at close in West Virginia carries  
1010 with it significant execution and operational risks. Even Frontier acknowledges that this  
1011 is probably the single most challenging aspect of the transaction. As Ms. Baldwin  
1012 delineates in her testimony, the sheer magnitude of tasks, software programs, databases,

---

<sup>50</sup> *Id.*

1013 hardware upgrades, data extracts, training, and personnel implicating every element of  
1014 this transaction in West Virginia (and beyond) raises the distinct possibility of unforeseen  
1015 negative consequences. As I have previously mentioned, I am not suggesting that  
1016 Frontier is in the same position as was FairPoint. However, this aspect of the deal  
1017 contains some of the same risks that ultimately brought FairPoint to its knees. While  
1018 Frontier and its advocates argue that a major difference is that the West Virginia  
1019 properties will be converted to an existing system, rather than a newly-created one, the  
1020 fact remains that there are significant risks of failure which could have important  
1021 financial consequences. Beyond the mere complexity of the cutover and the other factors  
1022 identified by Ms. Baldwin, there are two important factors that I hope the Commission  
1023 scrutinizes very closely:

- 1024 • This is an enormous, and I believe unprecedentedly large, first-day cutover  
1025 attempt. Even FairPoint had ten months after the close before the cutover  
1026 occurred; and,
- 1027 • As confirmed by Mr. Gregg, this represents the first attempt to acquire and  
1028 integrate a portion of a former Bell Atlantic wireline operating company.<sup>51</sup>

---

<sup>51</sup> Response to CWA Second Discovery, response 31.



**PUTTING IT TOGETHER: FRONTIER IS NOT FINANCIALLY FIT TO OWN AND  
OPERATE VSTO**

**Q. Have you reached any conclusions about Frontier's financial fitness to own and  
operate Verizon's VSTO operations in West Virginia and 13 other states?**

A. Yes, I have. Based on my analysis of Frontier's current business model, Frontier's  
unrealistic projections of revenue increases and expense reductions, and Frontier's  
dramatic planned reductions in the level of capital spending in VSTO, I conclude that  
Frontier is not financially fit to own and operate Verizon's VSTO operations.

**Q. How did you reach your conclusions?**

A. These conclusions stem from the totality of my analysis, which initially led me to doubt  
the credibility of Frontier's public representations, and subsequently spurred me to  
explore the company's financial and synergy models very closely. That exploration,  
combined with reams of documents, confirmed my suspicion that Frontier would be  
taking on enormous potential risks which, if they came to bear, Frontier would in no way  
be capable of confronting.

There are a number of ways to test the credibility of a firm's financial projections,  
one of which is to subject its model to something of a "forensic" analysis. This entails  
what could be described as an inside-out exploration of the entire model, to understand  
how it works, to judge whether or not its output is meaningful, and possibly to use it as a  
tool to test alternative scenarios (or sensitivities). In this case, Frontier's proforma model  
yielded information about the assumptions the company has made, particularly with

1050 respect to the data it determined to insert into the program rather than subject it to further  
1051 manipulation (of which there is much). I would describe the model's output as somewhat  
1052 useful, but limited for the purposes of testing the credibility of Frontier's plans. It only  
1053 permits two basic (very aggressive) scenarios for standalone VSTO and three fairly  
1054 narrow scenarios for standalone Frontier. It combines the results of these limited  
1055 standalone scenarios, but those results are not particularly useful in understanding the  
1056 likely financial behavior of the firm under financial stress.

1057         Fortunately, the question that I wanted to explore is quite straight forward: what  
1058 risks can reasonably be deduced by examining the financial impact of plans gone  
1059 seriously awry? From my initial analysis, it was clear to me that Frontier is banking on  
1060 projections that have a fairly high risk of not coming to fruition. Significant  
1061 underperformance on either the revenue or expense side can lead to similar pressures. In  
1062 the end, it all gets down to available cash and the competition for access to it within a  
1063 firm. While I can't predict with any precision how badly Frontier might undershoot its  
1064 projections -- and I certainly don't know with any certainty how the company's leadership  
1065 would respond in such a situation -- I can say with a high degree of certainty that it would  
1066 do *something*. Management would obviously react and make changes. The question  
1067 would be whether it still had sufficient resources available to it and what the magnitude  
1068 of its financial distress might imply about the decisions it might take.

1069 **Q. Please describe your analysis.**

1070 <<<BEGIN CONFIDENTIAL & PROPRIETARY

A.

Category	Reads
1	~1000
2	~500 + ~500
3	~1000
4	~100 + ~700 + ~200
5	~150 + ~850
1076	~800
6	~200 + ~850
7	~1000 + ~50
8	~150 + ~150 + ~650
9	~150 + ~250 + ~550
10	~1000
11	~550 + ~400
12	~150 + ~750 + ~50
13	~1000
14	~350
15	~200 + ~750
16	~450 + ~450
17	~150 + ~150 + ~550

Direct Testimony of Randy Barber  
Case No. 09-0871-T-PC

1113 [REDACTED]

1114 [REDACTED]

1115 [REDACTED]

1116 [REDACTED]

1117 [REDACTED]

1118 [REDACTED]

1119 [REDACTED]

1120 [REDACTED]

1121 [REDACTED]

1122 [REDACTED]

1123 [REDACTED]

1124 [REDACTED]

1125 [REDACTED]

1126 [REDACTED]

1127 [REDACTED]

1128 [REDACTED]

**END CONFIDENTIAL & PROPRIETARY>>>**

**Q. What were the results of your financial analysis of Frontier under stress?**

A. As I describe in more detail in my confidential testimony, I tested what the impact would be on the combined Frontier/VSTO if no synergies are achieved over the mid-2010-year-end 2014 timeframe. While I obviously can't predict what the company's management would do under such circumstances, this would clearly be a significant event with large financial implications.

**Q. What do you conclude?**

A. It is my conclusion that in such a situation, Frontier/VSTO would come under enormous pressure to reduce outlays anywhere it could (as well as raise revenues if it could). Three obvious targets for downward adjustment would be service, capital expenditures, and dividends. While I cannot disclose the precise results of this analysis in the public part of my testimony, I can say that the lost profits and cash flows represent a large proportion of the dividends and capital expenditures that Frontier intends to pay over that four and one-half year period.

1129 **CONCLUSION**

1130 **Q. Based on your financial analyses, what do you conclude?**

1131 A. I conclude that the proposed transaction contains fundamental flaws that cannot be  
1132 remedied. Frontier is not financially fit to own and operate Verizon's operations in West  
1133 Virginia and the 13 other states Frontier is proposing to acquire. In my opinion,  
1134 therefore, the only way for the Commission to protect the public is to deny the  
1135 Application and reject the proposed transaction.

1136 **Q. If the Commission disagrees with you and believes that it is possible to condition the**  
1137 **proposed transaction to protect the public, are there conditions you would**  
1138 **recommend?**

1139 A. At the outset, I must reiterate that I do not believe it is possible to adequately protect the  
1140 public from the very serious risks that would be posed by having Frontier take over  
1141 Verizon's operations in West Virginia. Frontier simply does not have the financial  
1142 capability to safely and reliably operate, maintain, and enhance Verizon's network.

1143 If the Commission disagrees, however, then I would urge it to approach its  
1144 decision in this case deliberately and without haste. In spite of the Applicants' seeming  
1145 impatience to obtain approval of the proposed transaction, it is now clear that even under  
1146 the best of circumstances the deal will not close before mid-year. In his rebuttal  
1147 testimony in Ohio, Frontier's Daniel McCarthy indicates that Verizon is required to  
1148 demonstrate, by operating them separately over a sixty day period prior to closing, that it

1149 has successfully "replicated" the former GTE back office systems in the thirteen states  
1150 other than West Virginia. These systems will support the operations in those states and  
1151 will only be available in the Fort Wayne, Indiana data center beginning in April 1010.  
1152 This means that the transaction would close, at the earliest, in June 2010.<sup>52</sup> With a  
1153 closing at least seven months away, if it determines to approve this transaction in some  
1154 form, the Commission has more than enough time to evaluate the cutover and systems  
1155 replication processes, institute a third party audit (as I recommend below), verify that  
1156 Frontier's financing is complete and affordable, and generally insure that the Applicants  
1157 fully meet any conditions the Commission should establish.

1158 Moreover, because the merger agreement (at paragraph 2.2) requires closing to  
1159 occur on the last business day of a month, it would appear that the earliest possible  
1160 closing date would be June 30, 2010.

1161 Again, if the Commission decides to approve this transaction in some form, I  
1162 would recommend the conditions outlined below. I do not believe that these conditions  
1163 would fully insulate the public from the numerous risks and adversities that I believe are  
1164 likely to occur if Frontier were put in charge of Verizon's network in West Virginia. But  
1165 these conditions would at least ameliorate some of the most serious risks of the  
1166 transaction.

---

<sup>52</sup> Before the Public Utilities Commission of Ohio, Rebuttal Testimony of Daniel McCarthy on Behalf of Frontier Communications Corporation, November 4, 2009, pp. 47-48.

1167 First, I embrace Ms. Baldwin's recommendations with respect to systems  
1168 integration, cutover monitoring, broadband deployment, and service quality. I would  
1169 also reiterate that I am very concerned about the risks inherent in the proposed  
1170 transaction. Verizon has done this type of transaction twice before (in Hawaii and  
1171 Northern New England) and both times have been abject failures, resulting in the  
1172 financial failure of the acquiring companies, a significant deterioration in customer  
1173 service, and significant expenditures by regulators, labor unions, CLECs, public  
1174 advocates, and other interested parties.

1175 Because these risks are so large – and the deal (as proposed) does little if anything  
1176 to address them – I do not believe that the Commission should even consider approving  
1177 the transaction unless it is substantially restructured to ensure that Verizon retains  
1178 responsibility until there is a full and complete transition of operations. Therefore, my  
1179 first recommendation would be that the Commission should insist that the applicants  
1180 fundamentally renegotiate the overall transaction.

1181 **Q. What do you mean by "fundamentally renegotiate the transaction?"**

1182 A. Simply put, the Commission should not agree to let Verizon walk away from its  
1183 operations at closing. The last three Verizon asset divestitures resulted in the financial  
1184 failure of the new firm (Hawaiian Telcom, Idearc, and FairPoint). Verizon must remain  
1185 responsible until it has been demonstrated that the new Frontier is truly financially viable.



1186 **Q. How would you recommend that the Commission insist that Verizon remains**  
1187 **responsible until Frontier and Verizon have demonstrated the viability of the new**  
1188 **combined firm?**

1189 A. Broadly, I would suggest two alternative approaches to retaining Verizon's involvement.  
1190 While the details of each would obviously require much elaboration, both have the virtue  
1191 of ensuring that Verizon continues to have significant "skin in the game," unlike the  
1192 Hawaiian Telecom, Idearc and FairPoint experiences where Verizon fundamentally  
1193 walked away after the transactions were consummated. The idea behind each of these  
1194 alternatives is to ensure that Verizon's long-term interests are aligned with success of the  
1195 proposed transaction.

1196 Verizon Frontier Joint Venture: Create a Joint Venture ("JV") between Verizon  
1197 and Frontier, with specific milestones that must be met before Verizon can sell its interest  
1198 in the venture. (See below for milestones.) Rather than an all-or-nothing solution, a JV  
1199 would permit a much more orderly transition from Verizon to Frontier ownership,  
1200 retaining Verizon's "skin in the game" while also providing Frontier with appropriate  
1201 incentives to manage the transition smoothly. This approach also has the benefit of being  
1202 reversible (that is, Verizon can be required to repurchase Frontier's interest in the JV) if  
1203 the Verizon/Frontier partnership fails to meet the expectations of regulators or the  
1204 companies. Finally, the financial burdens imposed by the proposed structure of the deal  
1205 on the properties being acquired can be mitigated through an appropriate exit pricing

1206 mechanism that recognizes the actual economic value of the new entity, not the projected  
1207 value.

1208 It also is possible that the JV would be beneficial to both companies for the  
1209 indefinite future. The Verizon Wireless JV between Verizon and Vodafone has been  
1210 quite successful. Both companies have retained their interests, contributed additional  
1211 capital, and worked together to create a successful company.

1212  
1213 Verizon Warranty or Guarantee: An alternative to the JV would require Verizon  
1214 to provide a warranty (or guarantee). The warranty would remain in place for the longer  
1215 of five years or the time it takes for Frontier to achieve certain milestones (see below).  
1216 Verizon (or its predecessors GTE / Bell Atlantic) has owned these utilities for many  
1217 decades. Verizon should be required to stand behind these operations for a reasonable  
1218 period while Frontier works to absorb them. The warranty would cover system  
1219 operations (all computer systems, network operations center, etc.), condition of plant and  
1220 equipment, adequacy of inventory, accuracy of billing and customer data. Verizon would  
1221 be required to compensate Frontier for access line losses greater than the industry average  
1222 and for increased costs (and revenue losses) Frontier incurs as a result of faulty, incorrect,  
1223 or inappropriate data passed by Verizon to Frontier as part of the closing and cutover to  
1224 Frontier or standalone former GTE systems. Verizon would also be required, at its  
1225 expense, to correct any deficiencies that existed at closing, regardless of when the

deficiencies became apparent to Frontier (or customers or regulators). Needless to say, the terms of a Verizon guarantee would need to be extensively documented and clear dispute-resolution procedures created.

**Q. You mentioned "milestones." Please explain.**

A. The milestones I outline below would be conditions that would have to be met before either the Joint Venture would be permitted to be dissolved or Verizon would be released from various warranty or guarantee-related obligations. These would be above and beyond any other on-going conditions that the Commission might impose on the new Frontier entity. The milestones would include: Frontier successfully converts from Verizon's systems onto the Frontier systems that will be used after the estimated 2-3 year transition period, and a minimum 2-3 year "proving" period thereafter. (If there are any systems acquired from Verizon that Frontier will use going forward, then Frontier must certify when they are operating fully to Frontier's satisfaction and according to predetermined specifications.)

a. Frontier documents that it has received accurate customer data – billing information, customer location, etc. Any deficiencies are resolved at Verizon's expense.

b. Frontier achieves and maintains an investment-grade bond rating from at least two of the major rating agencies (Moody's, S&P, Fitch).

- 1245 c. Frontier successfully refinances its corporate debt that matures from 2011  
1246 through 2013 (\$1.2 billion).<sup>53</sup>
- 1247 d. Joint Applicants should agree to a 3<sup>rd</sup> party audit of the systems  
1248 integrations process. An outside party, such as an auditing firm, should  
1249 perform tests of functionality and reliability of the new systems, and affirm  
1250 to the Commission that the systems in question will perform the way they  
1251 are intended to perform on the date of transfer, that is, that the systems will  
1252 be able to process billing tasks, repair orders, personnel deployment,  
1253 wholesale orders, etc.
- 1254 e. The Joint Applicants should provide broadband availability to 100% of its  
1255 territory within three years. Intermediate milestones should be: (1) 3  
1256 Mbps to 90% of the broadband eligible access lines within two years of the  
1257 Transaction Closing Date; and (2) 7 Mbps to 75% of broadband eligible  
1258 access lines within one year of the Transaction Closing Date, 85% of  
1259 broadband eligible lines within two years of the Transaction Closing Date,  
1260 and 100% of broadband eligible lines within three years of the Transaction  
1261 Closing Date; and (3) symmetric 5 mbps to 100 % of broadband eligible  
1262 lines within five years of the Transaction Closing Date.
- 1263 f. Verizon should submit a report to the Commission detailing current  
1264 broadband deployment at a very granular level (e.g. on an address-by-  
1265 address basis).
- 1266 g. Verizon should provide comprehensive data about its infrastructure,  
1267 broadband locations, broadband speeds, etc., in the format that is required  
1268 by the West Virginia “eligible entity” responsible for broadband mapping

---

<sup>53</sup> Frontier Communications, SEC Form 10-Q, November 4, 2009, pages 12, 18 and 19. In 2014, Frontier will also need to refinance or otherwise fund the \$600 million in debt that it issued in April 2009.

under the NTIA guidelines so that Frontier does not need to incur that expense and to facilitate the state's ability to achieve its broadband goals in a timely manner.

h. Joint Applicants should commit to allocate sufficient resources in West Virginia to coincide with the time that systems integration occurs so that Frontier is able to handle any possible spikes in customer calls and complaints. Sufficiency of resources should be measured by examining resources for business as usual and scaling up to accommodate higher volumes of calls and possible problems at the time of the transfer to Frontier's platform.

i. Before systems are shifted from the Verizon platform to the Frontier platform, Joint Applicants should provide a report to the Commission outlining its plans.

j. Verizon should pay for an audit to be conducted of its network under the supervision of the Commission, with proposals submitted to the Commission, and the auditor selected by the Commission.

**Q. As you are aware, Ms. Baldwin also makes a number of recommendations to the Commission in the event that it determines to approve the transaction without the restructuring alternatives that you suggest. Do you have any such recommendations in the financial realm?**

A. Yes. Below I set forth a series of financial conditions that I believe -- in combination with those proposed by Ms. Baldwin -- are the minimum conditions necessary to ensure that the transaction will not harm the public in West Virginia.

Changes in Responsibility for Verizon (former GTE) Computer Systems

1. Restructure the transaction so that it does not require payment for maintenance or use of back office systems (e.g., the \$94 million annual maintenance fee for Verizon / former GTE systems).
2. Verizon's obligations for technical support should continue at no cost until such time as the Commission determines that the transition from Verizon's platform to Frontier's platform has been successfully completed, based on a third-party audit.

Financial Conditions (Ring Fencing)

The West Virginia utility will not be permitted to guarantee any debt of Frontier or any affiliate of Frontier. Frontier will not pledge or otherwise encumber the stock of the West Virginia utility. Any capital contributions from Frontier, or any affiliate of Frontier, to the West Virginia utility will be made through a combination of debt and equity that maintains the capital structure of the West Virginia utility with a minimum of 40% common equity and a maximum of 60% common equity.

1. Any debt from Frontier, or any affiliate of Frontier, to the West Virginia utility will carry an interest rate that is no higher than the lowest interest rate on Frontier's public debt of similar maturity.
2. The West Virginia utility shall not pay a dividend to Frontier, or any affiliate of Frontier, that is more than 90% of the West Virginia utility's net income in the year to which the dividend relates.<sup>54</sup>
3. The West Virginia utility shall not pay a dividend to Frontier if doing so would result in the West Virginia utility's capital structure falling below 40% common equity.
4. The West Virginia utility shall not pay a dividend to Frontier if, during the preceding year, its capital expenditures were less than 90% of its depreciation and amortization.

Financial Conditions (Debt)

I am very concerned that no information is available about the interest rate, or other terms and conditions, of the approximately \$3 billion in new debt that Frontier will be issuing for this transaction. The merger agreement (section 7.18(e)) states that Frontier may, but

---

<sup>54</sup> I believe a similar dividend restriction should be imposed on the parent company, but it is unclear if the Commission has the ability to do so.

1327 is not required to, walk away from the transaction if the interest rate exceeds 9.5%.  
1328 Frontier's CFO has stated that he does not expect to even begin the process of obtaining  
1329 this financing until January 2010 and that he doesn't expect to have financing in place  
1330 until March or April 2010.<sup>55</sup> Thus, as presently structured, the record in this case would  
1331 close before there is any definitive information about the debt issuance.  
1332

1333 In my opinion, the Commission should not even consider approving a transaction where  
1334 the terms and conditions of the financing are not known. Given this uncertainty, I would  
1335 propose the following conditions:  
1336

- 1337 1. Frontier must receive separate Commission approval prior to closing if the  
1338 weighted average annual cash interest rate (including annual accretion of  
1339 original issue discount) exceeds 8.5%
- 1340 2. The debt for this transaction should not include a pledge of stock,  
1341 guarantee, or other encumbrance on the West Virginia utility.
- 1342 3. If the debt includes conditions that place Frontier in default or that change  
1343 the interest rate based on Frontier's leverage ratio (net debt / EBITDA),  
1344 the trigger for such conditions shall be no less than 4.5x.

---

<sup>55</sup> Transcript of Frontier analysts' conference call, Aug. 4, 2009.

1345 **Q. Do you have any other points you would like to make for the consideration of the**  
1346 **Commission?**

1347 A. Yes. In my experience, first with FairPoint and now with this deal, there seems to be an  
1348 underlying concern that, if this transaction is turned down, Verizon will simply ignore the VSTO  
1349 properties and allow them to stagnate. Put another way, there is a palpable worry that Verizon  
1350 would leave states like West Virginia on a side-road of the information super-highway.

1351 While I obviously cannot know what Verizon would do in the face of a rejection, I would  
1352 point out two things: Verizon executives will still have a fiduciary responsibility to maximize  
1353 the financial benefits of the assets under their control and regulators still have tools to enforce  
1354 their policies.

1355 Moreover, Verizon today is offering much faster internet service than is Frontier in West  
1356 Virginia. It has also not been established how much of the gap between the Frontier and Verizon  
1357 broadband penetration is due to competitors offering viable alternatives to DSL (and the  
1358 Applicants profess a startling ignorance about the actual level of competition in West Virginia).

1359 Finally, it may be instructive to examine another case where Verizon tried -- and failed --  
1360 to divest itself of "non-core" wireline assets. In 2004, Verizon confirmed to the New York Times  
1361 that it was considering selling off its wireline assets in upstate New York, from Orange county to  
1362 Buffalo. It is not clear why Verizon abandoned this effort -- there were vocal opponents and  
1363 reports that the company failed to obtain the price it was seeking. However, Verizon began  
1364 installing FTTH cable throughout the region and in 2006 it began offering high-speed FiOS



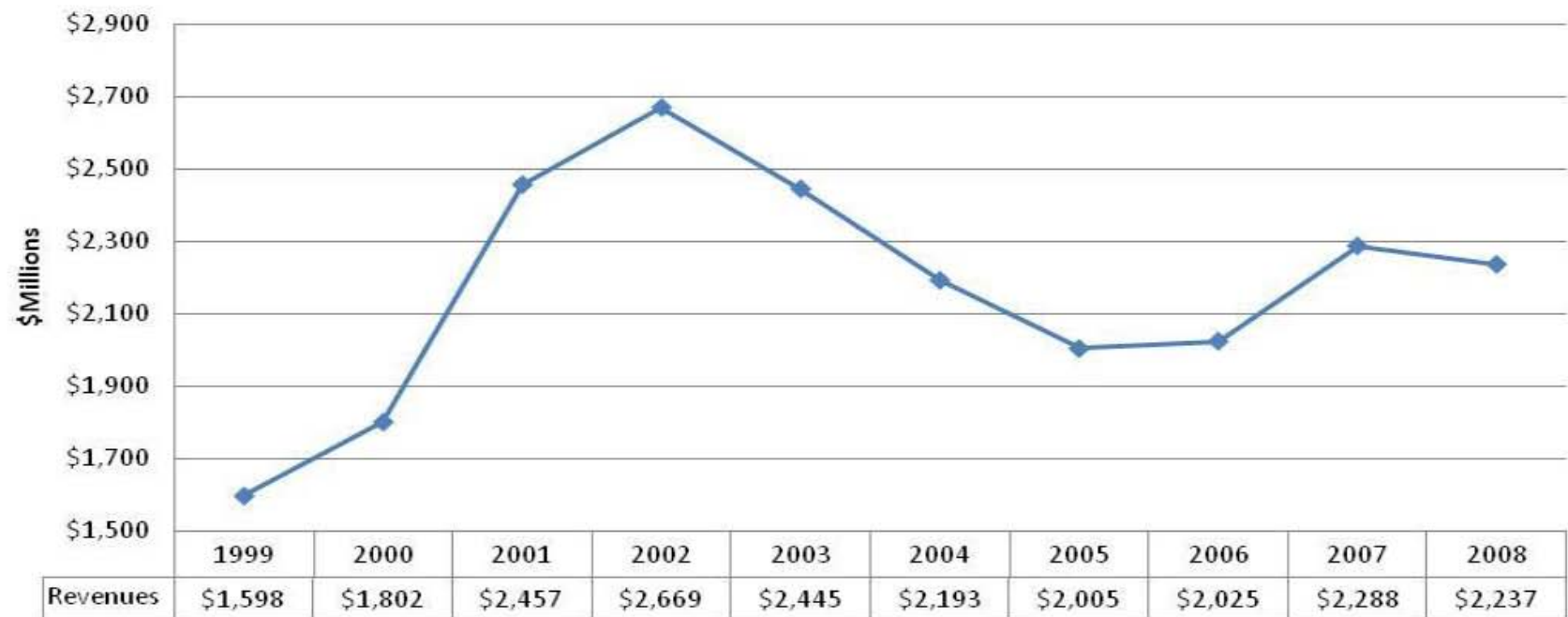
1365 internet in the Buffalo area. Soon thereafter, it began offering FiOS TV and, during 2007 and  
1366 2008 alone, it invested \$886 million in its upstate New York telecommunications infrastructure.

1367 I firmly believe that it would be a fundamental mistake for the Commission to approve  
1368 this proposed transaction simply because of the belief that, in the face of a rejection, Verizon  
1369 would simply permit its West Virginia assets to atrophy. It has many incentives to maximize its  
1370 profits, even in the face of circumstances that are not completely of its choosing. And the  
1371 Commission has to tools to encourage the company to do so.

1372 **Q. Does this conclude your direct testimony?**

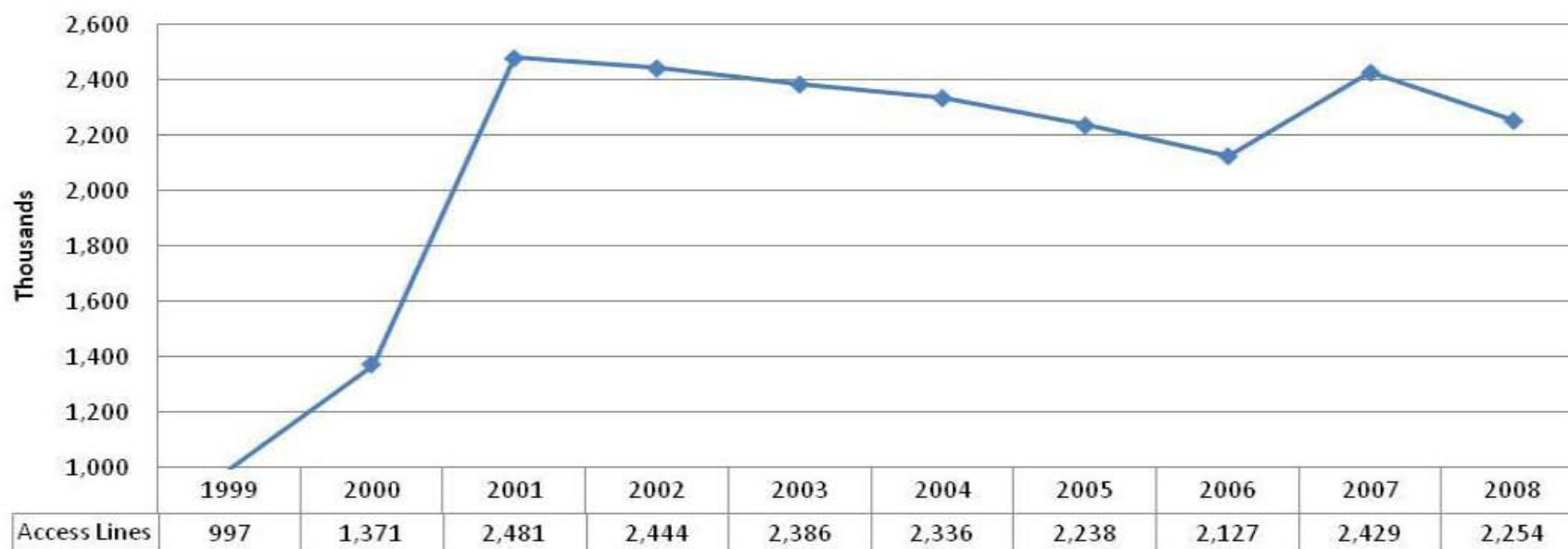
1373 **A.** Yes, it does,

## Schedule 1. Frontier Communications: Revenues 1999-2008



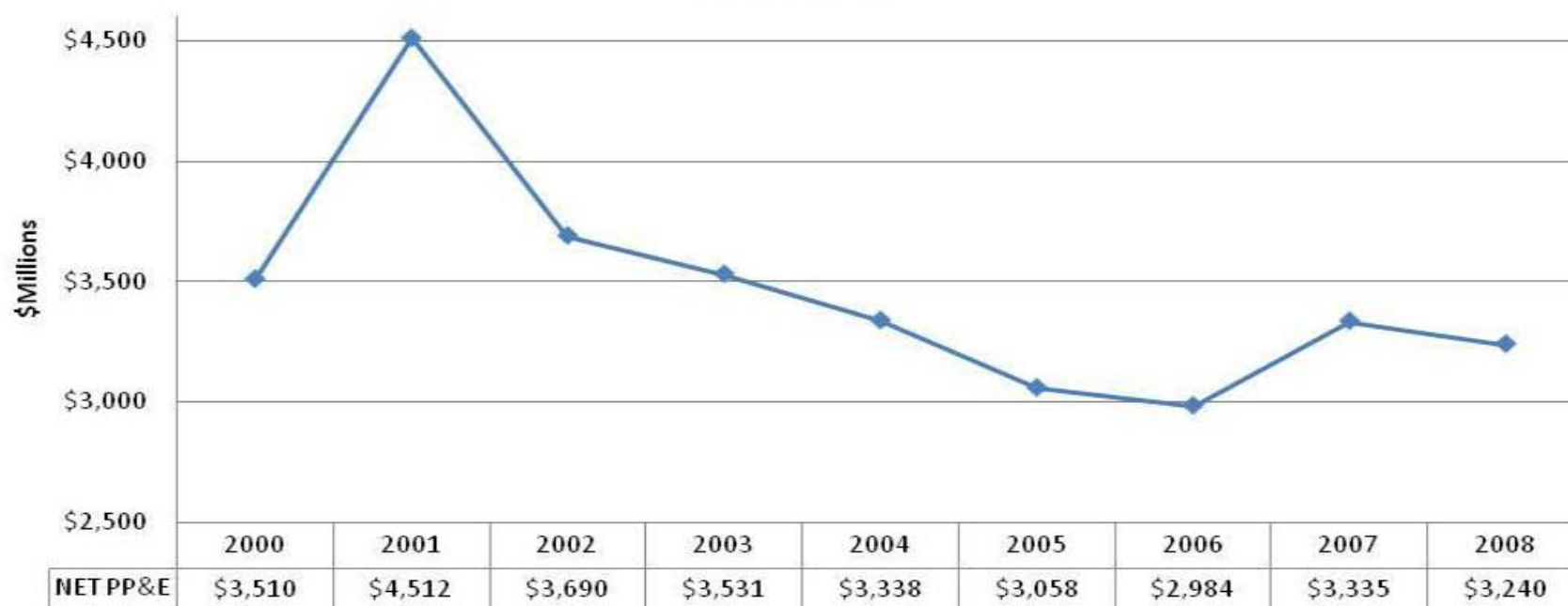
Frontier SEC Forms 10K, filed March 9, 2001, March 24, 2003, March 14, 2005, March 1, 2007 and February 27, 2009; pages F-3, F-3, F-5, F-5, and F-5, respectively.

## Schedule 2. Frontier Communications: Access Lines 1999-2008



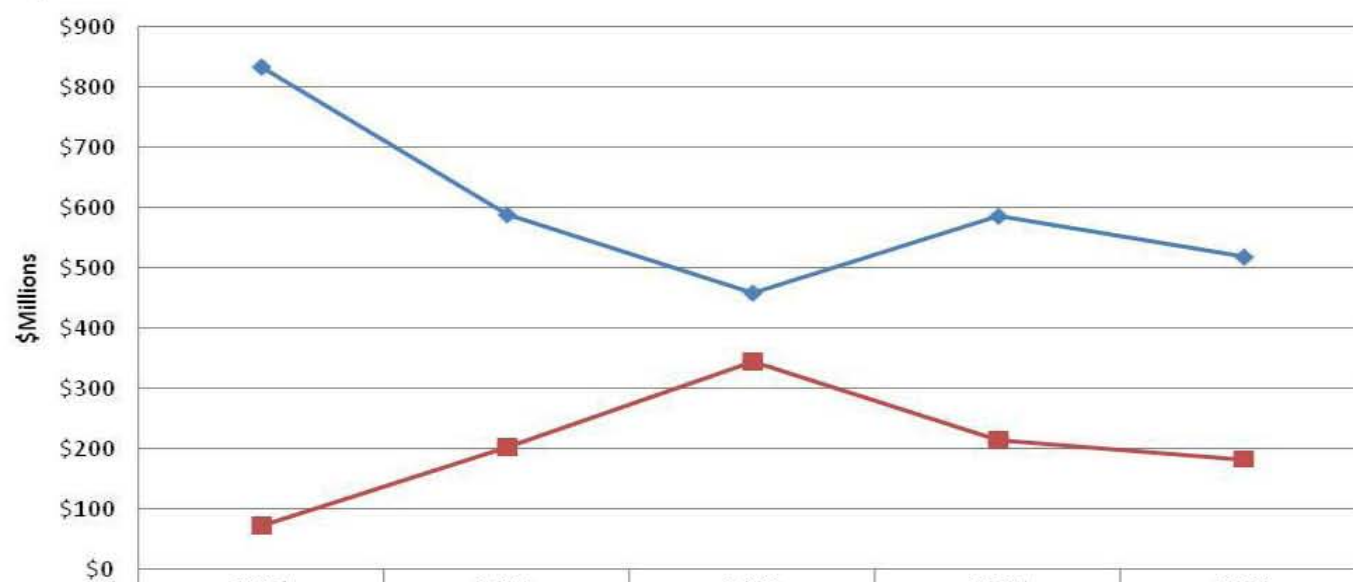
Frontier SEC Forms 10K, filed March 9, 2001, March 24, 2003, March 14, 2005, March 1, 2007 and February 27, 2009; pages F-3, F-3, F-5, F-5, and F-5, respectively.

### Schedule 3. Frontier Communications Net Property, Plant & Equipment 2000-2009



Frontier SEC Forms 10K, filed March 9, 2001, March 24, 2003, March 14, 2005, March 1, 2007 and February 27, 2009; pages F-3, F-3, F-5, F-5, and F-5, respectively.

### Schedule 4. Frontier Communications: Payments to Shareholders vs. Net Income 2004-2008



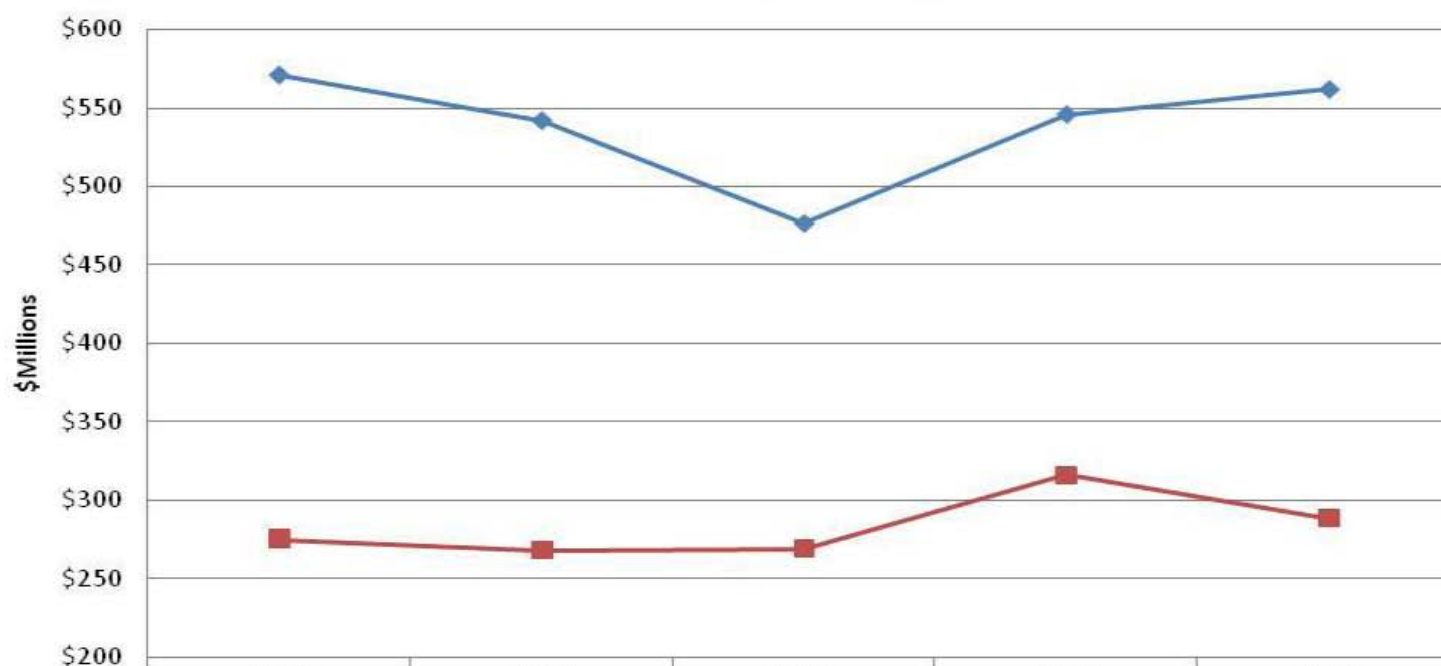
— Payments to Shareholders (Dividends & Buybacks)

— Net Income

Note: Frontier began paying dividends and engaging in share repurchases in 2004.

Sources: Frontier Forms 10K filed with the SEC on March 1, 2007 and February 27, 2009; page F-8 in both filings.

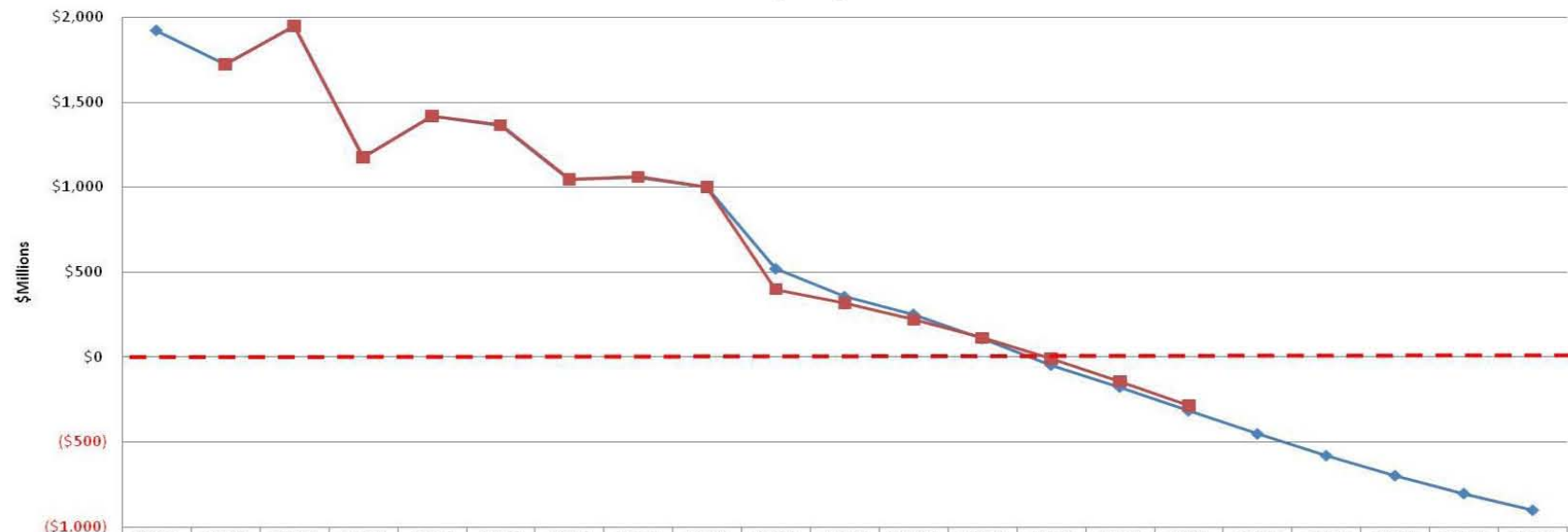
### Schedule 5. Frontier Communications: Depreciation & Amortization vs Capital Expenditures



	2004	2005	2006	2007	2008
◆ Depreciation & Amortization	\$571	\$542	\$476	\$546	\$562
■ Capital Expenditures	\$275	\$268	\$269	\$316	\$288

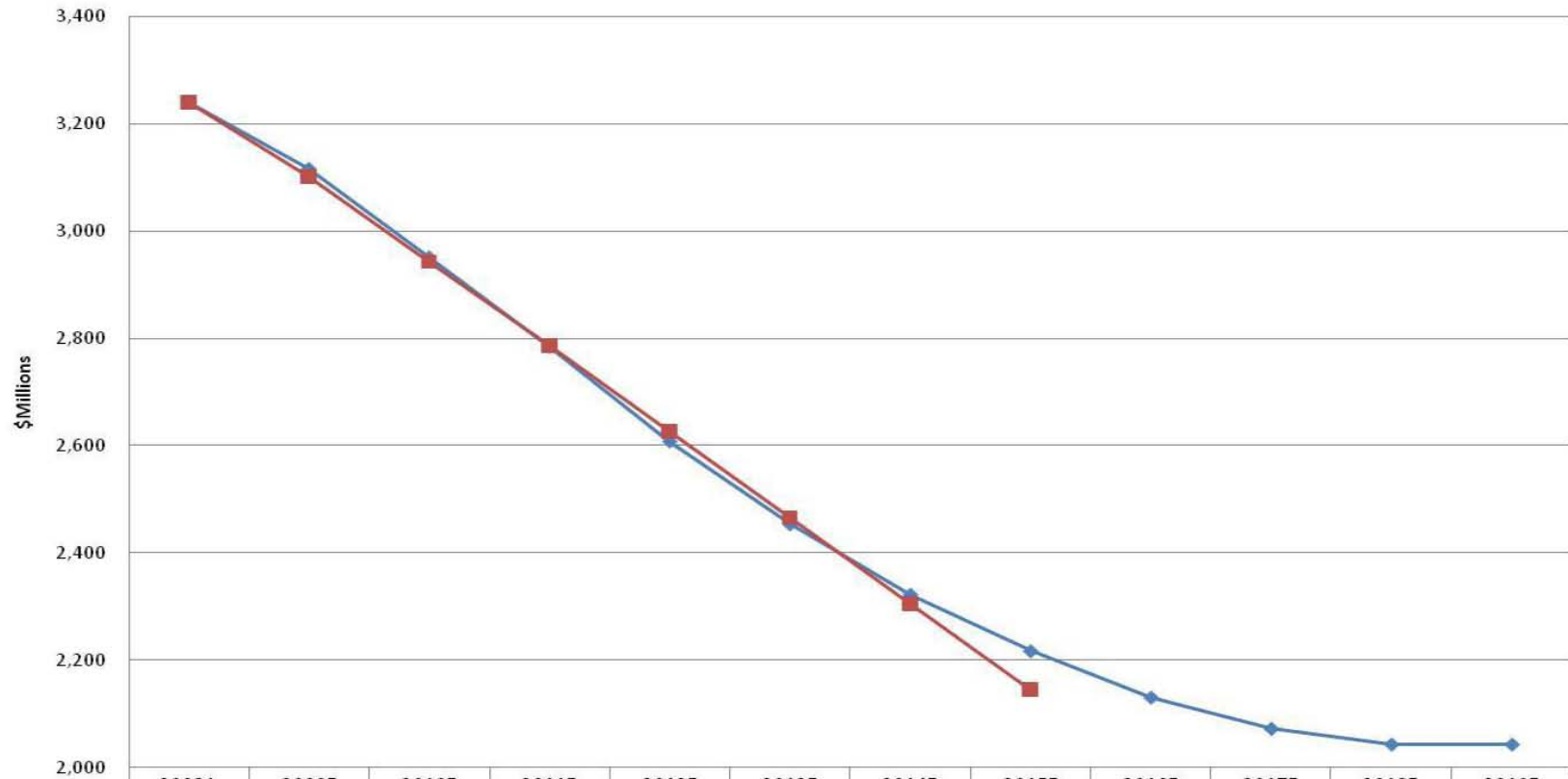
Source: Frontier SEC Forms 10K, filed March 3, 2007 and February 27, 2009, pages F-8 in both filings.

### Schedule 6. Frontier Communications (Standalone) Total Shareholder Equity: 1999A-2019E



Sources: Goldman Sachs (November 4, 2009, Tab "BS," Row 49) and Morgan Stanley (November 11, 2009, Tab "BS and Cash Flow," Row 58), financial models for Frontier Communications. Projections are for Frontier on a standalone basis.

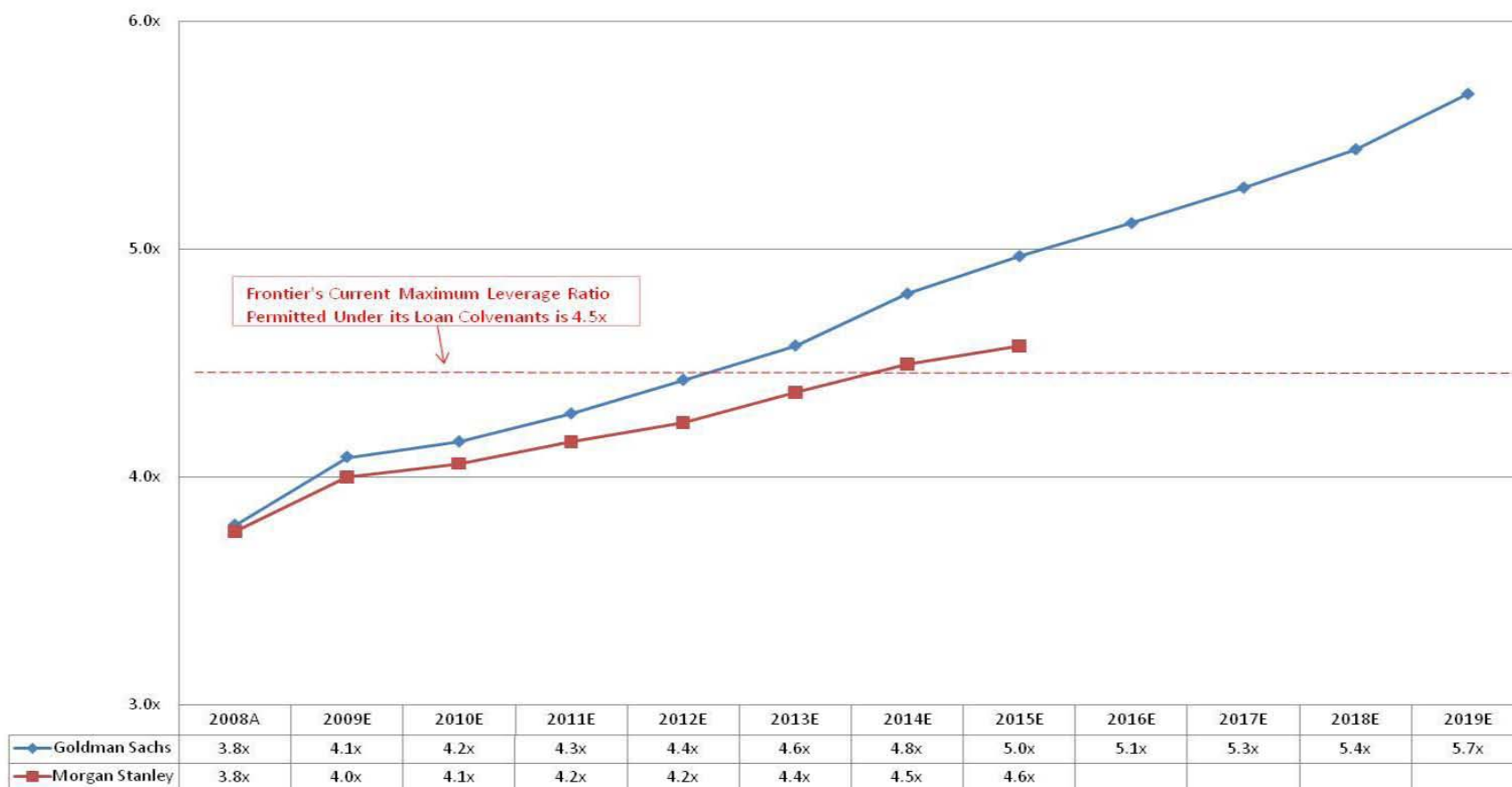
**Schedule 7. Wall Street Projections for Standalone Frontier:  
Net Property, Plant & Equipment  
2008-2019**



Sources: Goldman Sachs (November 4, 2009, Tab "BS," Row 17) and Morgan Stanley (November 11, 2009, Tab "BS and Cash Flow," Row 20), financial models for Frontier Communications. Projections are for Frontier on a standalone basis.

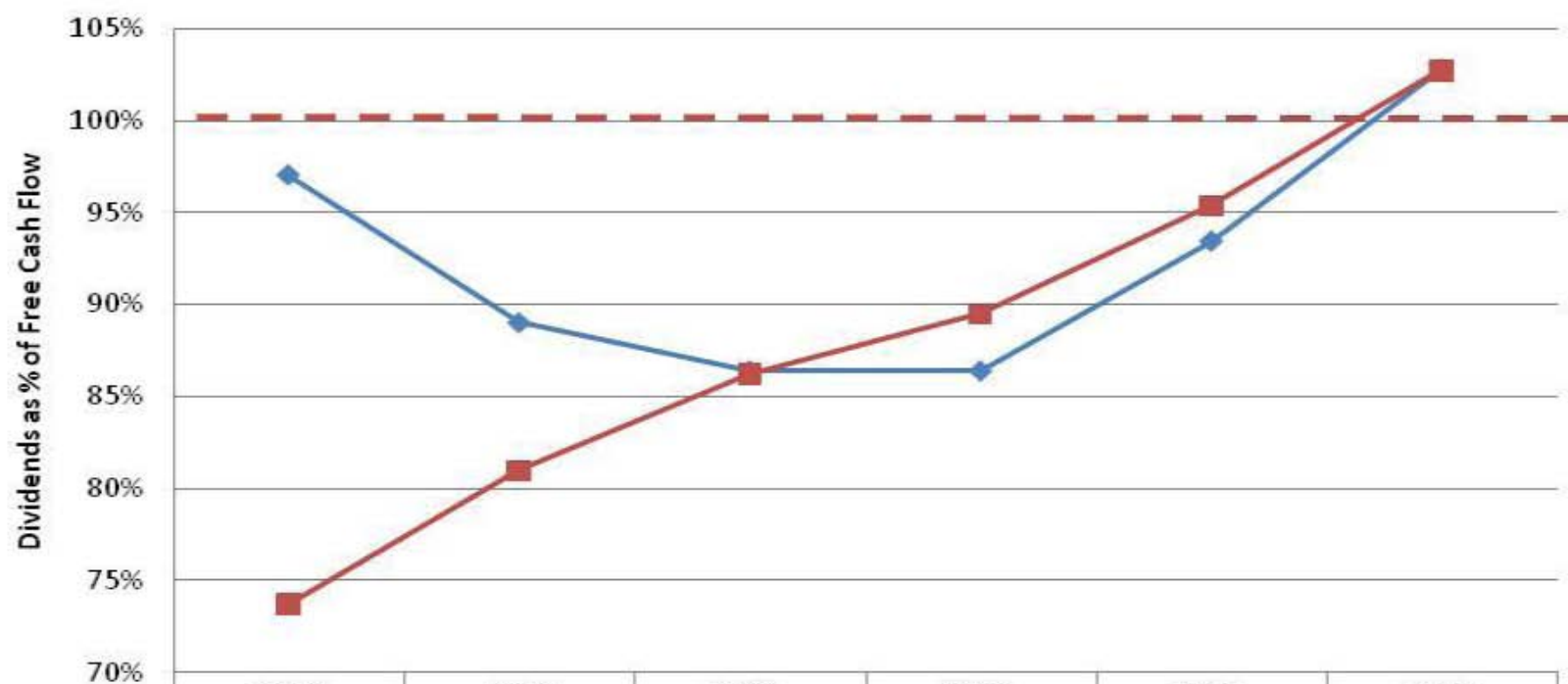


## Schedule 8. Wall Street Projections for Frontier Leverage Ratios (Standalone): 2008-2019



Sources: Goldman Sachs (November 4, 2009, Tab "BS," Row 68) and Morgan Stanley (November 11, 2009, Tab "BS and Cash Flow," Row 89), financial models for Frontier Communications. Projections are for Frontier on a standalone basis.

## Schedule 9. Wall Street Projections for Standalone Frontier Dividends as a Percent of Free Cash Flow 2009-2014

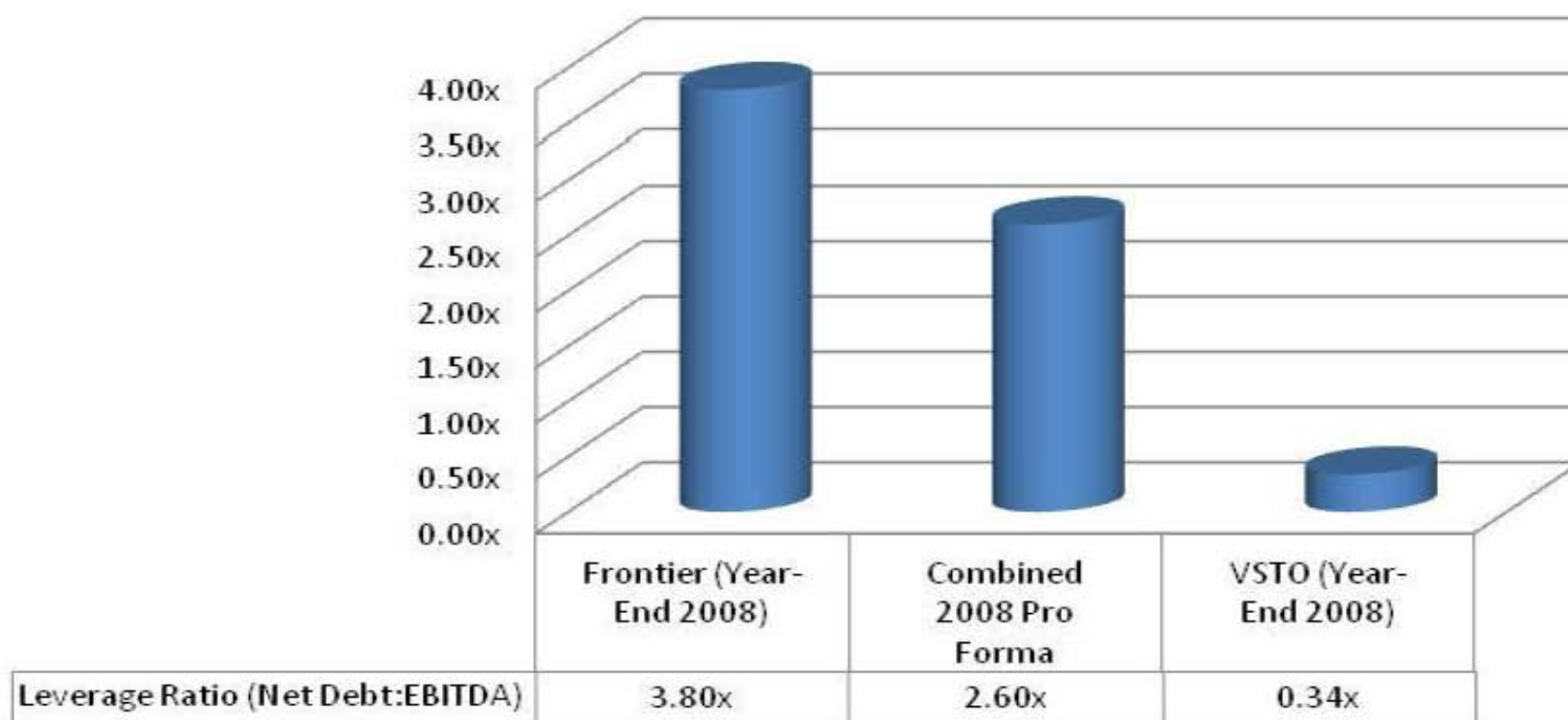


—◆— Goldman Sachs

—■— Morgan Stanley

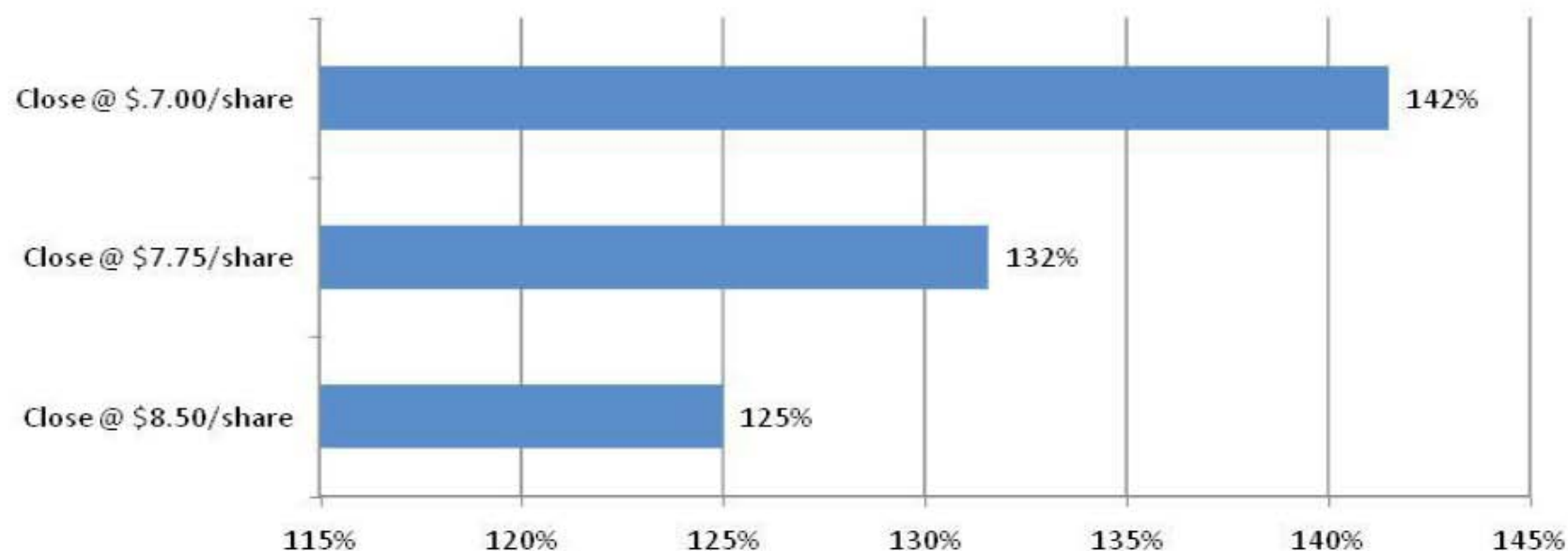
Sources: Goldman Sachs (November 4, 2009, Tab "CF," Row 43) and Morgan Stanley (November 11, 2009, Tab "BS and Cash Flow," Row 178), financial models for Frontier Communications. Projections are for Frontier on a standalone basis.

## Schedule 10. The Verizon Separate Telephone Operations' Leverage Ratio Will Increase Dramatically if the Frontier Deal is Approved



Sources: WV Case No. 09-0871, Joint Application, p. 12, footnote 6; Verizon reply to CWA DR 32, July 21, 2009

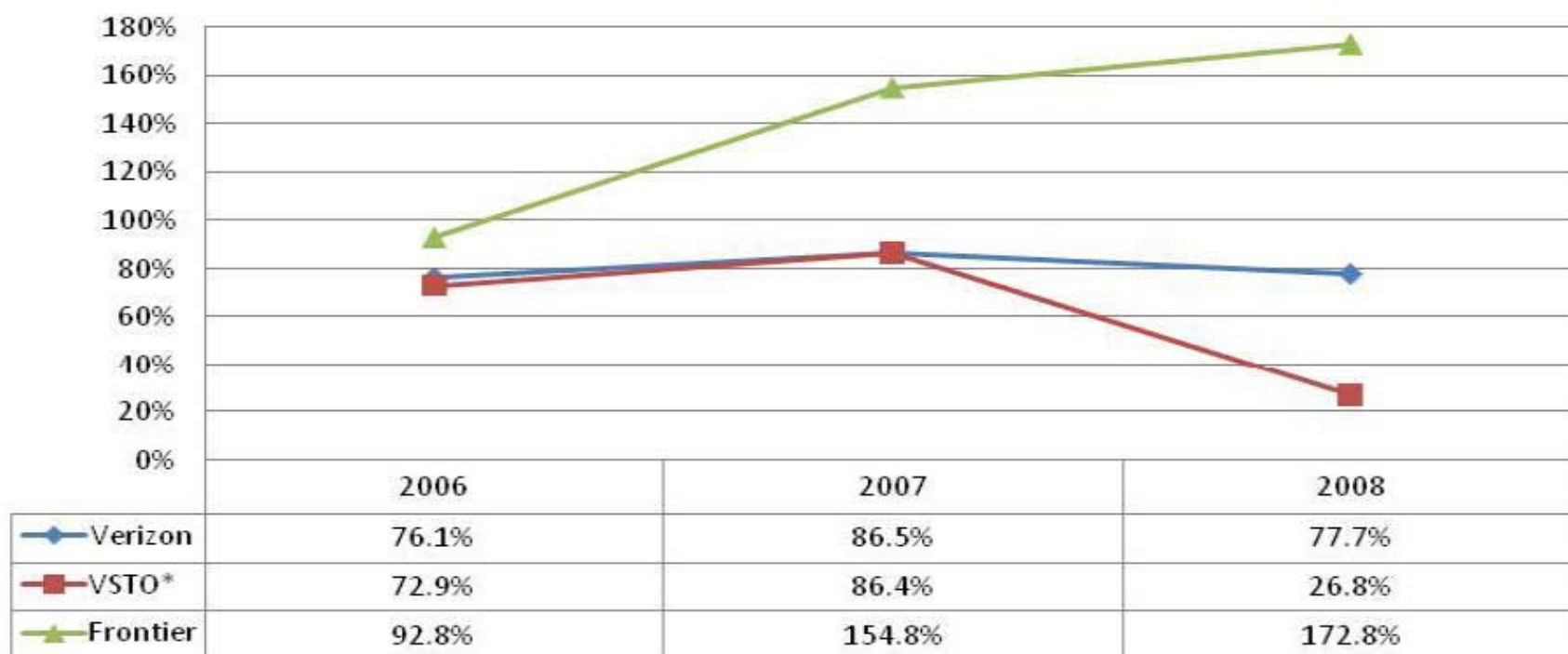
### Schedule 11. Frontier's Promised \$0.75/Share Dividend as % of 2008 Pro Forma Combined Net Income



■ Total Shares Issued to VZ Shareholders Depends on Frontier's Price at Close (currently trading in low \$7 range)

Source: Frontier SEC Form 424B3, Prospectus; Filed September 16, 2009; p. 177

## Schedule 12. Frontier, Verizon, and VSTO\* Dividends\*\* as % of Net Income



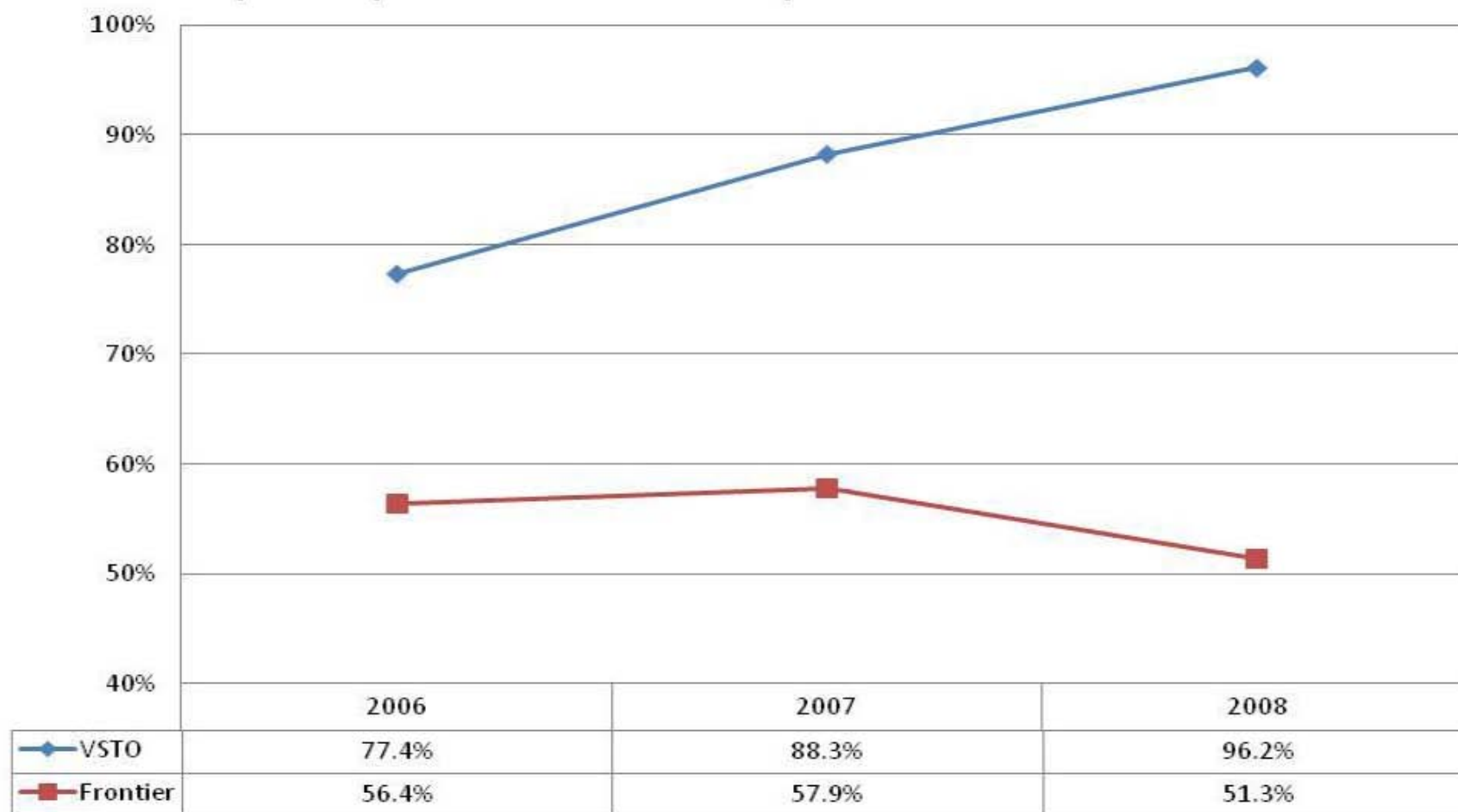
\* VSTO = Verizon Separate Telephone Operations

\*\* For VSTO, Parent Funding, Allocations, Intercompany Reimbursement as % of Net Income

Sources: Frontier SEC Form 424B3 Prospectus, filed September 16, 2009, pages F-27 and F-78; Verizon SEC Form 10K, filed February 24, 2009, Consolidated Statements of Cash Flows, unpaginated

## Schedule 13. Frontier and VSTO\*

### Capital Expenditures as % of Depreciation & Amortization



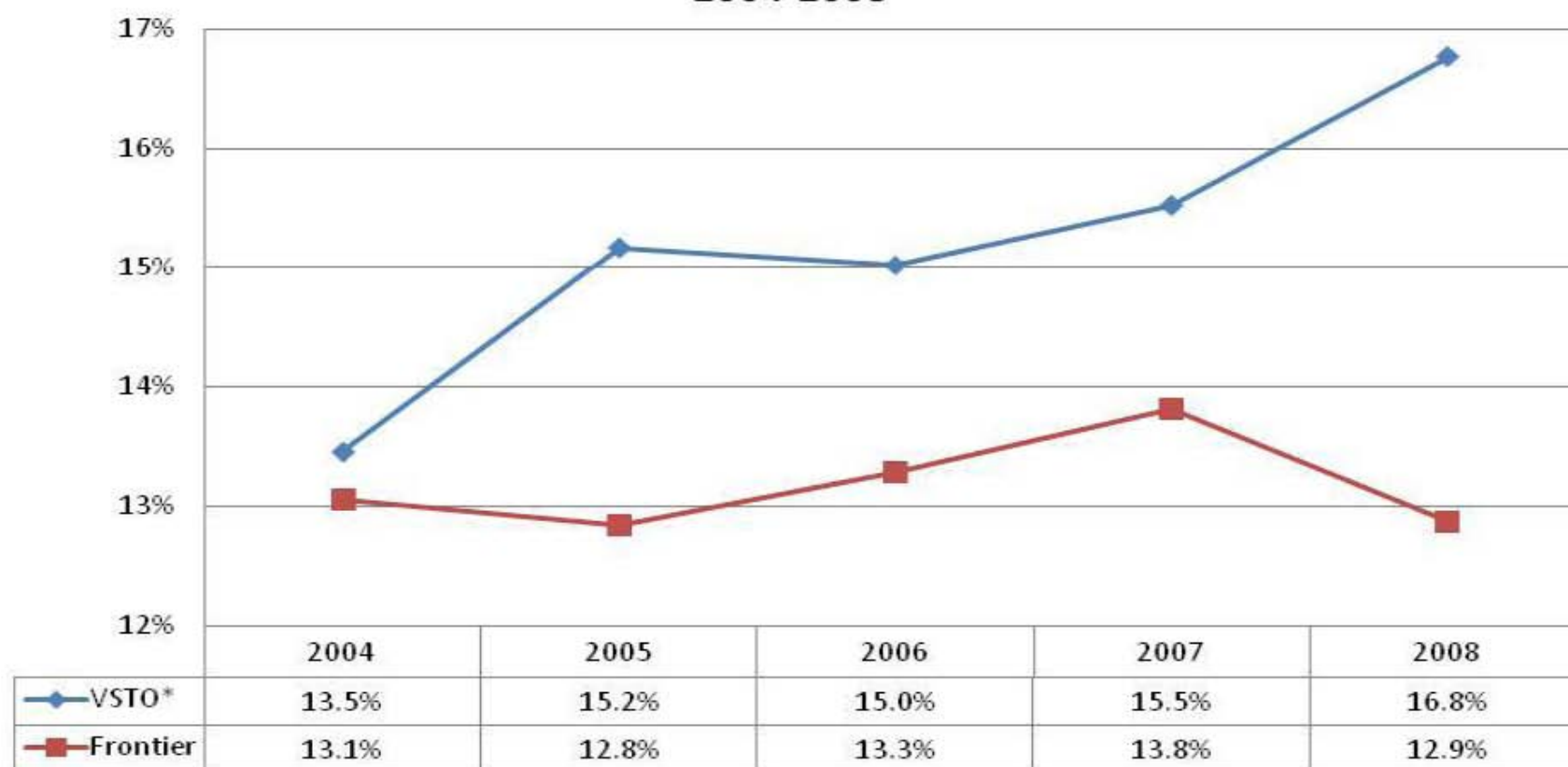
\* VSTO = Verizon Separate Telephone Operations

Sources: Frontier SEC Form 424B3 Prospectus, filed September 16, 2009, page F-78; Frontier Form 10K, February 27, 2009, p. F-8.

## Schedule 14. Frontier and VSTO\*

### Capital Expenditures as % of Revenues

2004-2008



\* VSTO = Verizon Separate Telephone Operations

Source: Frontier SEC Form 424B3 Prospectus, filed September 16, 2009, pages 16 and 19